



**Cross-submission**

**Electricity Lines Business**

**Optimised Deprival Valuation  
Handbook Conference**

**Public Section**

**14 - 16 April 2004**



**Cross-submission  
Electricity Lines Business  
ODV Handbook Conference 14 – 16 April 2004**

Orion thanks the Commission for the opportunity to present our views at the Commerce Commission conference on the ODV handbook. This cross-submission follows up on a number of matters which arose during the conference that Orion would like to comment further on, and also responds to the Commission's requests for further information from Orion.

The key points that we wish to make are:

- In relation to electrical contracting work on the Orion network, Orion operates a contestable and transparent tendering process underpinned by NZS 3910:1998 Conditions of Contract for Building and Civil Engineering Construction
- Orion's contracting subsidiary Connetics operates profitably and at arms-length from Orion
- Due to the specialist nature of work in some areas, no viable real time market exists and in this case contracts are let for limited terms (no longer than three years). These contracts are in specialist areas and contribute in only a minor way to the total pool of work on offer
- Replacement costs for cables as detailed in the Commissions' draft ODV handbook are too low.

In responding to the issues raised by the Commission, Orion is providing information which is of a **confidential** nature for which public disclosure would be prejudicial to the commercial position of Orion and other parties identified in these **confidential** extracts. We will detail the specific areas for which we would request confidentiality later in our submission.

Also appended to this cross-submission is a response from NERA in respect to the Commission's request for further information on the valuation of easements.

Firstly Orion would like to correct and clarify a number of issues raised during our presentation at the conference.

**1. The Ilam project – replacement of overhead lines**

In regard to the example of the Ilam cable project, we would like to correct any misunderstanding that this project involves overhead lines being replaced with cables (see page 395 ff). This is not the case. The Ilam project does not involve replacing overhead lines with underground cables. Rather it involves the installation of additional cables in this area to provide bulk transfer of energy to the new Ilam substation to complement and provide additional capacity to existing underground cables that were installed in the mid 1960s. The existing cables have approximately half their life left and will continue to service existing load in the area.

**2. The inclusion of the value of easements in FRS-3**

At page 417 Ms Bates raised an issue in relation to the inclusion of easements in Orion's FRS-3 valuation and asked whether the rule in the handbook that only allows

easements established since 1994 to be included in the regulatory valuation also applied to the FRS-3 standard.

We believe that FRS-3 allows us to include the value of easements whether established before or after 1994 because they meet the definition of assets as defined under the Statement of Concepts, namely:

*Assets are service potential or future economic benefits controlled by the entity as a result of past transactions or other past events.<sup>1</sup>*

We intend bringing this asset into our FRS-3 valuation in future years.

We advise that we consider that the value of the easement can be included whether we have paid cash for them or not. In accordance with paragraph 5.22<sup>2</sup> of FRS-3 where an asset such as an easement is acquired below fair value then the value of the “subsidy” received is to be recognised as income in the statement of financial performance, and the asset recorded at fair value.

### **3. Lines on private property**

With reference to the Transcript, p419, lines 8-14, there was some confusion over the proportion of high voltage line length that is on private property in Orion’s rural area. We confirm that this is approximately 14% (ie 400km in 3,000km).

### **4. Orion’s replacement costs**

We note from the Transcript and the questions that have been raised by the Commission that there may be a perception that Orion’s replacement costs are excessive. For example comments such as “*where you see a much higher replacement cost for cables submitted by Orion than any other distribution business*” together with other comments made by the Chair (page 393) indicate that the Commission may consider that Orion’s cabling costs are greater than for other similar businesses.

However, from the material presented by both Vector and PowerCo at the conference it would appear that Orion is not alone in its estimation of the costs of cabling and in fact our values appear to be lower than Vector and PowerCo’s values. Refer to our answer to Question 21.

### **5. Local conditions for cabling**

We note the Commission’s comments pages 403 and 404 with respect to upgrading of sidewalks etc. These requirements are imposed upon Orion by the Christchurch City Council and the same requirements apply to all other utilities in the city region.

The comment recorded in the Transcript, p411, lines 24-26 needs correcting. Earlier information that Orion received was that Auckland sewers often run along easements behind houses, but more recent advice is that this is not the case and sewers are beneath the streets in Auckland, the same as in Christchurch.

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<sup>1</sup> Clause 7.7 Statement of Concepts for General Purpose Financial Reporting

<sup>2</sup> Clause 5.22 FRS-3

## 6. Transfer pricing

The issue was also raised as to the efficiency of Orion and the possibility that Orion may in some way be assisting Connetics by engaging in arrangements which artificially inflate Connetics' profitability at the expense of higher average construction costs for Orion. We note that this appears to be a particularly concern of the Commission in relation to cable construction because in cable construction Orion's costs significantly exceed those proposed in the Commissions' draft handbook. Orion categorically refutes this suggestion.

The intention of Orion's adoption of a competitive contracts model was to encourage competitors into the contracting business. Orion was one of the first companies, if not the first, to adopt a competitive tender process for work on its network. We understand that this is a position that some companies have yet to adopt.

In following parts of this submission

- we outline Connetics' profitability compared to its peers in the construction industry;
- we outline Orion's pre-eminent place over the last decade in both competitive tendering and in the accounting separation and later the corporatisation of its "contracting branch" in order to enhance transparency and further encourage the presence of other competitors in the market;
- we outline Orion's current tendering policies and practices and the distribution of work awarded amongst tenderers.

These issues are addressed extensively later in this submission. Whilst our response is predominately related to the provision of cables, Orion's tender process also applies to most other construction work undertaken including lines and substations.

Orion is more than happy to provide any further assistance the Commission may require to clarify this issue.

## 7. Planning horizon

We note question 6 to Transpower – *"Please provide a real life example of where Transpower has made an investment decision consistent with a 35 year planning horizon."* ( Day 2, Transcript, p 192). We make the following brief comments in relation to this issue because we consider that it also relates to the planning periods for optimisation required by lines businesses as previously submitted by Orion..

In Appendix C of our submission on "Asset Valuation Issues" (19 November 2003) page 46 we explained the basis that we used for optimisation –

*"(b) The same annual linear growth rates were assumed. However, instead of being limited to considering future loading at limited planning periods of five years (secondary feeders) and ten years (primary feeders), the same linear growth rates were used to project loadings 35 years into the future. This was considered conservatively reasonable because:*

- *The loading growth rates are based on the rate of growth of power loadings – 0.5% to 1.2%. While Orion has been able to limit growth in power loadings in recent years, the future load growth rate is likely to be more like the rate of growth in energy volumes of 1.6% to 2%.*

- *On average, 11kV cables have 60% of life remaining. Most of these are of paper-lead insulation construction with lives of 70 years. Hence, most will remain in service over 35 years.”*

In using a planning horizon of 35 years, we are effectively assuming that the capacity of assets in service today will still be required in 35 years time.

Further, whenever we install distribution assets, we expect them to be used for at least 35 years and when we undertake long term planning studies for key investment decisions, such as to construct a new zone substation or to change voltage in an area from 11kV to 33kV or 66kV, we will consider the expected loadings for 35 years.

## 8. Additional questions

Orion has identified from the Transcript that we offered to provide a response to the following question:

*“If you value the easements for whatever purposes, do you think you open yourself up to a problem for Council of saying on the one hand you want a value here you’re not being rated on, maybe you should be rated?” Page 433*

The current situation is that under the Rating Act, the Christchurch City Council charges rates to the owner of the land. As the holder of an easement Orion would therefore expect no additional rates liability to arise. We consider it would take a change to council policy and possibly the Rating Act for the Council to apply rates based on an entity’s interest in the land controlled via an easement.

## 9. Response to the Commission’s questions

Orion’s response to the questions the Commission has identified in its paper entitled *“Information to be provided post conference”* are detailed below. We have used the same numbering of questions as in the Commission’s paper.

### **Question 15**

***Please indicate how the revaluation gain due to Orion’s change to FRS 3 was treated.***

All of Orion’s revaluations have been accounted for in the Statements of Movements in Equity in accordance with the requirements of FRS-3. The only time this would not occur is when there is a reduction in value in a class of assets (say land) and there isn’t enough in the revaluation reserve to cover the reduction for that category of asset (ie below cost). In that case any excess has to be expensed in the Statement of Financial Performance. In other words the revaluation reserve must not drop below zero for any class of asset.

Paragraph 7.13 of FRS-3 states that:

*7.13 Subject to the requirements of paragraphs 7.14 and 7.15 of this Standard, when an item of property, plant and equipment is revalued, the resultant revaluation increment or decrement must be recognised in the statement of movements in equity.*

*7.14 If the revaluation of an item of property, plant and equipment results in a revaluation deficit for the class of property, plant and equipment to which that item belongs, the revaluation deficit must be recognised in the statement of financial performance.*

*7.15 To the extent that the revaluation of an item of property, plant and equipment reverses a previous revaluation deficit, for the class of property, plant and equipment to which that item belongs, that was recognised in the statement of financial performance, such revaluation increment must be recognised in the statement of financial performance.*

Orion has followed the requirements of FRS-3, and complied with GAAP, by recognising the revaluation within equity, specifically within a revaluation reserve. This has been the accounting policy since Orion's first revaluation in 1992.

The financial statements contained within Orion's disclosures prepared in accordance with the Electricity (Information Disclosure) Regulations incorporate the FRS-3 valuations and therefore comply with GAAP. However, as required by the Regulations, for derivation of the Regulatory ROI the FRS-3 accounting book values are replaced by the regulatory book values (ODV) which have been determined in accordance with the Handbook.

**Question 16**

***Please provide information on the relationship between Orion and Connetics, including the agreement covering the supply of contracting services by Connetics to Orion and the tenders currently existing.***

***and***

**Question 17**

***Please provide the tenders made by Alstom to Orion prior to Alstom exiting its activities in Orion's network area.***

To respond to questions 16 and 17 it is useful to provide some background to the history of Orion and Connetics, together with providing additional information on Orion's policies in regard to letting contracts.

In the late 1970s supply within what is now Orion's "area" was from a city-council-owned Municipal Electricity Department (MED); the adjoining Central Canterbury Electric Power Board (CCEPB); and some small MEDs owned by Heathcote, Lyttelton and Riccarton councils.

In 1987 the Christchurch City Council (CCC), using the SOE model, put its MED at arms length from the council organisation structure, and appointed some outside directors to its policy-making board.

In the same year the CCEPB approached the CCC suggesting that the two energy undertakings merge. In February 1989 Southpower commenced operations, structured as an unincorporated joint venture between the CCC and the CCEPB.

A fully commercial structure was set up. Assets and staffing were rationalised, and although it was not then legally possible to incorporate a company, the business was run to all intents and purposes as if it were a company, completely separate from the CCC and CCEPB.

After local government mergers occurred in 1989 the Heathcote, Lyttelton and Riccarton MEDs were purchased. Elsewhere in New Zealand electricity was still being supplied by MEDs and power boards.

In this early stage of Southpower all construction works were carried out in-house. This was the normal practice of all but the smallest power boards - which relied on their larger neighbours to assist them. For example, the CCEPB assisted the Chatham Islands, and the MED assisted Riccarton. As part of this process of moving to a more commercially focused company, the works sections of the merging companies were rationalised and the decision made to expose this newly created contracting arm to competitive pressures.

Southpower Contracting Services division was created, from 1991, to operate as a stand alone business unit of Southpower Limited.

From 1991, the amount of maintenance and construction work that Southpower put out for competitive tender gradually increased. The annual report for 1993 stated

*“During the past year quarter of network contracts were made contestable and this proportion is being significantly increased in the coming year”<sup>3</sup>.*

Connetics Limited was corporatised in April 1996, and became (and remains) a wholly-owned subsidiary. *“The change has allowed the company to target a wider range of utility and local government clients. It has been immediately successful in tendering for work throughout the country, including in Auckland, Wellington and the West Coast.”<sup>4</sup>*

Since corporatisation, Connetics has operated as a completely stand-alone self-sufficient entity.

It operates separate:

- corporate
- board
- IT
- financial, and
- human resource functions.

Connetics rents its own site of operations from an unrelated party, physically removed from Orion.

Orion does lend working capital to Connetics and invests surplus funds as part of a combined treasury operation, but advances to Connetics are interest bearing and at a margin above Orion's cost.

Connetics operates independently from Orion with a significant proportion of its revenue derived from sources other than Orion. It also operates separate divisions internally. The detail relating to these issues are considered **confidential** and are further expanded upon in Annex C.

The above history can be seen reflected in the summary of cable contracts contained in Table 1. This table and its supporting documentation are contained in Annex A due to the **confidential** nature of the material. The table indicates that prior to the year ending 1991 all work was carried out in-house by Southpower. In subsequent years the amount of work that was let out to contestable tender increased with a range of different contractors winning a variety of the contestable work, including Southpower Contracting/Connetics which was also competing for this work.

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<sup>3</sup> Southpower Annual report 1993 p12

<sup>4</sup> Southpower Annual Report 1996 p 11

Thus Southpower moved at a very early stage to capture the efficiencies that could be gained by contracting out construction work, a move that we understand many line companies have still not adopted, choosing instead to continue with an in-house non contestable approach.

It can also be seen from Table 1 that over the years there has been a number of different contractors involved with the percentage of work in dollars terms varying between them.

The supporting documentation to this table indicates that, particularly in the early days, there was a wide range of contractors tendering. This number has decreased over the years. This reduction in the number of contractors, is due in part to the limited amount of work that is available within Christchurch and New Zealand as a whole, together with the need for expensive specialised equipment and technical expertise. This is reflected in Table 1 by the contract which was awarded to overseas company Olex Cables in 2000 and 2001. This particular contract related to the turnkey provision of 66kV cabling for which there is limited New Zealand expertise available.

### **Orion's evaluation of tenders**

To assist the Commission in response to question 17, the contract details supplied in Annex B contain a number of tender offers for a variety of contracts when Alstom was a tenderer prior to its exit from the market. Each of the contracts shown in Annex B have been subdivided into sections:

- Tender administration
  - invitation to tender
  - assessment of tenders
  - awarding of tenders
- Contract document set
- Contract administration

For completeness we have included all the tender offers in the section "Assess Tenders" except for the successful tender which is contained in the "Contract Document set" to allow the Commission to compare these offers.

To provide an explanation to the Commission of the process that Orion uses in evaluating tenders we have included, in Appendix B, copies of Orion's policy documents in relation to:

1. Contract Management Policy
2. Contract Tendering Policy
3. Evaluation of Tenders

Orion uses as a basis for its contracts "The General Conditions of Contract NZS 3910:1998, Conditions of Contract for Building and Civil Engineering construction". This basic contract is modified or extended in each specific contract that is let.

Orion awards contracts based on the lowest price conforming tender method. In summary, this tender evaluation process comprises two stages:

- The first stage consists of determining tender acceptability when assessed against each of seven non-price factors – namely: Relevant Experience, Track Record, Competency and Technical Ability, Adequacy of Safety, Quality Assurance, Customer Service, Management Skills.
- The second stage consists of Orion determining which of the remaining conforming tenders has the lowest price.

From the above and the information provided in Annex A and B, it can be seen that Orion's contracting model is based on receiving a series of tenders and we do not have a specific single contract with any contractor that covers all the services provided by that contractor. This produces "deep" contestability by not eliminating competitors due to the provision of a broad contract for only one company.

In addition to the normal construction work identified above, which comprises around 90% of Orion's construction expenditure, Orion also has a set of standalone contracts with a number of contractors for limited terms ( no longer than three years). These contracts are of a specialist nature and Orion believes that they are necessary in this form to ensure the ongoing quality and reliability of the Network.

We have included in Annex B copies of the contracts which we have with Connetics in relation to the following specific specialised work areas:

- Emergency Works
- Network Storage & Emergency Spares
- Cable Management Agreement

In addition to the above Orion also has the following specialised contracts in place:

- Design Services Consultancy - Connetics
- General Design Services Consultancies with:
  - BECA
  - Linelink
  - Mitton
  - Maunsell
  - MWH
  - SKM
- Distribution Transformer Maintenance - Connetics
- Ripple Maintenance - Connetics
- SCADA Maintenance - Connetics
- Partial Discharge Testing - Hamer Technology
- Tree Management (3 defined geographical areas) with:
  - Cherry Picker Specialists
  - Electrix
  - Southern Tree Maintenance

We will discuss these contracts with you in further detail at our forthcoming meeting.

**Question 18. Please provide details of the financial performance of Connetics since its formation.**

Orion's response to this question is contained in Annex C as it is **confidential** and release of the information would be prejudicial to Orion and Connetics.

**Question 19 How did Orion derive the recommended zone substation building economic life of 70 years?**

Orion's recommendation of 70 years economic life for substation buildings was based on Orion's (Southpower's) practice of using a life of 70 years for this asset when determining ODVs up until 31 March 1999. This previous practice was considered appropriate (and agreed with our technical valuers) because:

*"Our buildings are substantial structures which we expect to last 70 years. The more recent buildings are reinforced concrete with a block infill and a concrete reinforced roof and are designed for a life well in excess of 40 years. These have been the standard building since the early 1970s. All buildings are thoroughly maintained and many have been strengthened in recent years to survive the maximum level of earthquakes that are ever expected in Christchurch. Expensive oil containment facilities have also been added. These buildings house transformers with 55 year lives and cables with up to 70 year lives and the buildings are designed to last at least as long as the life of their contents. Some of these are already 70 years old."*

This quote comes from correspondence with the Ministry of Commerce on this issue (letter dated 8 June 2000), when Orion then recommended 70 years.

In our submission to the Commerce Commission on the Review of Asset Valuation Methodologies (11 November 2002, page 32), we stated *"these need to be extended for substation buildings from 40 years to at least 70 years."*

In our submission to the Commerce Commission on the Valuation Issues Paper (11 September 2003, page 15 and pp38 & 39), we explained that for our FRS-3 valuation, we used 70 years because:

*"District substation buildings are of rugged permanent material design mostly using reinforced and filled concrete block construction. Remedial action is being taken to bring all district substations up to the latest building code and related seismic strength codes.*

*Similarly, building substations constructed since the mid-1960s are of permanent materials using mostly reinforced concrete framed masonry. Each has been included in Orion's seismic strengthening programme."*

In our submission to the Commerce Commission on the proposed Handbook (11 February 2004, page 20), we stated:

*"We therefore again submit that the Commission prescribes a realistic maximum asset life of at least 70 years for zone substation buildings because ELBs (including the prudent ELB that is deprived of its assets) generally design for longer lives such as 70 years as advised by Orion and other ELBs in their submissions. Orion's practice now is to replace switchgear, with 45 year life, twice in the life of a substation building. Therefore, the*

*building life is at least 90 years. We recommend increasing the maximum building life to 100 years to cater for all practices.”*

***Question 20. Please provide information on whether there are any instances, outside the gas sector in Australia, where regulators currently allow easements to be valued at replacement cost.***

See appendix A for a response to this question from NERA

***Question 21. Please provide the detailed variance analysis that explains the discrepancies the standard costs of 11kV and low voltage cables which arise between Orion and other line businesses and also as presented in the draft ODV handbook.***

The table following summarises the information items on cable costing that Orion has submitted to the Commerce Commission.

**Summary of information items submitted re cable costing**

Information item	Comment																												
<p>1. <u>FRS-3 costs</u></p> <p>Table of per unit length costs for 11kV and 400V cables used by Orion in its FRS-3 valuation at 31 March 2003. Refer to "Submission on Valuation Issues Paper," 19 November 2003, Appendix C, section 2.4, p43.</p>	<p>Summary table of costs per km of circuit length. These were derived from construction contracts – refer to next reference. They are average base costs, before multipliers. Only a limited review of multipliers was possible. Changes, with existing Handbook values in brackets were:</p> <table data-bbox="651 555 1244 698"> <tr> <td>Business (CBD + level 2 roads), average terrain</td> <td>1.6</td> <td>(1.25)</td> </tr> <tr> <td>Business, rocky terrain</td> <td>2.6</td> <td>(2.25)</td> </tr> <tr> <td>Rural, average terrain</td> <td>0.4</td> <td>(1.00)</td> </tr> </table>	Business (CBD + level 2 roads), average terrain	1.6	(1.25)	Business, rocky terrain	2.6	(2.25)	Rural, average terrain	0.4	(1.00)																			
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<p>2. <u>Cabling contracts data</u></p> <p>Schedule of cabling contract information that was used to obtain the averages used in the FRS-3 valuation at 31 March 2003. Refer to "Submission on Valuation Issues Paper", 19 November 2003, Appendix D, pp 54-58.</p>	<p>The cabling contracts span the period June 2002 (100% of contract completed) to March 2003 (1% of contract completed). The contractors were Connetics and Alstom. Statistics are:</p> <table border="1" data-bbox="655 831 1406 1115"> <thead> <tr> <th rowspan="2">Cable Type</th> <th rowspan="2">Length (km)</th> <th colspan="3">Contracts</th> </tr> <tr> <th>Used</th> <th>Outliers</th> <th>Total</th> </tr> </thead> <tbody> <tr> <td>11kV cables, heavy</td> <td>10.9</td> <td>6</td> <td>2</td> <td>8</td> </tr> <tr> <td>11kV cable, medium</td> <td>0.8</td> <td>2</td> <td>1</td> <td>3</td> </tr> <tr> <td>11kV cable, light</td> <td>2.1</td> <td>0</td> <td>5</td> <td>5</td> </tr> <tr> <td>LV cables, on own</td> <td>2.6</td> <td>3</td> <td>1</td> <td>4</td> </tr> </tbody> </table> <p>These contracts provided the comprehensive basis Orion needed to determine the average per km costs to use in the FRS-3 valuation. They were not cable-only contracts and so the costs of other work had to be removed.</p> <p>Note that a lot of this work occurred before the full implementation of the new codes on surface reinstatement and traffic management.</p>	Cable Type	Length (km)	Contracts			Used	Outliers	Total	11kV cables, heavy	10.9	6	2	8	11kV cable, medium	0.8	2	1	3	11kV cable, light	2.1	0	5	5	LV cables, on own	2.6	3	1	4
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<p>3. <u>Cost comparisons</u></p> <p>Table comparing cabling costs from the current Handbook to Orion's November 2003 revised costs. Refer to "Submission on Handbook", 11 February 2004, Appendix A, Cables.</p>	<p>This table summarises the cable costs from key sources, including from PricewaterhouseCoopers for 19 ELBs, Powerco and Vector.</p> <p>The Orion November 2003 costs assume 50% cabling in the footpath. The Orion November 2003 <u>revised</u> costs assume 90% cabling in the footpath.</p>																												
<p>4. <u>Cable costing contract</u></p> <p>Table of cabling costs resulting from a contract that Orion awarded specifically to determine a breakdown of 11kV cabling costs. Refer to "Submission on Handbook," 11 February 2004, Appendix C.</p>	<p>This table provides a full statement of cabling costs, based on Orion's Ilam cabling project, covering combinations of:</p> <ul style="list-style-type: none"> <li>• Light, medium, heavy and extra heavy cables;</li> <li>• Single and double configurations;</li> <li>• Average and rocky ground conditions;</li> <li>• Roading levels 1, 2 and 3;</li> </ul> <p>The analysis assumes 90% trenching in footpath.</p>																												

Information item	Comment
<p>5. <u>Code compliance costs</u></p> <p>Single page with table and notes that splits out all of the cabling cost components in detail, to illustrate the costs associated with complying with codes. Refer to email from N Ross "Further cable costing 23 Feb04.xls" to Commerce Commission and adviser at PBA, 23 February 2004.</p>	<p>The table in the Excel workbook attached to this email and its associated notes provides details of costs of installed cables – 11kV medium, LV medium (neutral screen) and LV medium (4-core). There are separate columns with data for Level 1 and Level 2 traffic management.</p> <p>The information in the notes explains the detailed breakdown of costs associated with jointing, tree management and dumping of unusable excavated material.</p> <p>This is the most comprehensive and most up-to-date statement of cabling costs that Orion has provided.</p> <p>The tabulated cable purchase cost, as a proportion of the total cost, varies from 16% to 30%. Refer to discussion in Transcript, p432, lines 31-33 and p433, lines 1-12.</p>

There are 7.5 pages of detailed tabulated data in the information referred to. For the purpose of answering question 21, we considered that it was appropriate to summarise only, with clear references, so that the Commission can refer to the detail, in context.

The progression of Orion's advising of cabling costs has been from a general to a more detailed level. Some variances have occurred in results because of:

- changes in assumed conditions e.g. item 2 versus item 4;
- changes in timing, from early 2002 (item 2) to February 2004 (item 5);
- corrections e.g. the 50% to 90% cabling in footpath in item 3;
- unravelling of components of cost, exposing omissions or anomalies, as in item 5.

Following, please find a table "Comparison of cable replacement costs per unit" which shows the variance in costs given in the submissions from PWC, Powerco, Vector and Orion against those given in the current and proposed ODV Handbooks. This is an expansion of what Orion has already provided to the Commission as item 3, above. We have added some more values that have been reported in 2004.

## Comparison of cable replacement costs per unit (\$/metre of circuit length)

Voltage	Size Desc	Size Range	Config-uration	Current Handbook 1995/97	Proposed Handbook Dec 03	PWC for 19 ELBs Nov 03	Powerco Nov 03	Vector [5] Feb 04	Vector [4] Nov 03	Orion FRS-3 Mar 03	Orion [6] Nov 03	Orion [7] revised Nov 03	Orion [8] Code Feb 04	Pwrco [9] Apr 04	Vector [10] Apr 04
11kV	Extra Heavy	Above 300mm <sup>2</sup> Al	On own							\$185 [1]	\$179	\$159			
11kV	Heavy	Above 240mm <sup>2</sup> Al to 300mm <sup>2</sup> Al	On own	\$120	\$125	\$126	\$137	\$130	\$140	\$160	\$162	\$142			\$211
11kV	Medium	Above 50mm <sup>2</sup> Al to 240mm <sup>2</sup> Al	On own	\$90	\$97	\$100	\$92	\$100	\$105	\$125	\$149	\$129	\$147		
11kV	Light	Up to 50mm <sup>2</sup> Al	On own	\$65	\$77	\$81	\$82	\$77	\$76	\$100 [2]	\$118	\$98			
11kV	Heavy		Dble circuit	\$85	\$85	\$85	\$110		\$99	\$115	\$113	\$102			\$192
11kV	Medium		Dble circuit	\$67.5	\$67.5	\$70	\$75		\$79	\$90	\$99	\$89			
400V	All	All	On own	\$55			\$80	\$63		\$100				\$116	
	Heavy	Above 240mm <sup>2</sup> Al	On own		\$72	\$75									
	Medium	Up to 240mm <sup>2</sup> Al	On own		\$63	\$65							\$130		
400V	All	All	With 11kV	\$25			\$40			\$45 [3]					
	Heavy	Above 240mm <sup>2</sup> Al	With 11kV		\$40	\$52									
	Medium	Up to 240mm <sup>2</sup> Al	With 11kV		\$32	\$37									

**Notes:**

- 1 Derived by adding additional cost of conductor (\$75/m - \$52/m = \$23/m) to cost of heavy 11kV cable .
- 2 Note these are based on rural u/g reinforcement examples where a different trenching technique is used.  
A multiplier of 0.4 was applied to the contract prices for the rural examples tested.
- 3 Meritec data.
- 4 Applied Vector's 16.4% average increase submitted (18 Nov 03) for 11kV cables. Expressed as 14.1% undervalued by previous Handbook.
- 5 Advised by Vector in submission to Commerce Commission. Apply to suburban areas, average ground conditions, route fully trenched.
- 6 50% buried in footpath.
- 7 90% buried in footpath.
- 8 Level 1 traffic management, 90% buried in footpath.
- 9 Average for cabling in brownfields situation. ODV Handbook Conference.
- 10 Advised at ODV Handbook conference as appropriate examples of competitive projects.

The costs submitted, as reported in this table, can be regarded as indicative only because there is insufficient information on the assumptions or the basis used. All values have some validity, but cannot reasonably be compared without some specification of the assumptions. In Appendix B of our submission to the Commission on the ODV Handbook (11 February 2004), we provided two tables (11kV and LV) comparing what we guessed was the basis for the Handbook costing versus Orion's basis. Even this was incomplete and we have not had a full open discussion with the Commission's advisers on this to enable both parties to fully understand the differences.

The proposed Handbook (clause A.14) states "*The maximum underground cable costs in Table A.1 have been based on laying underground cables in an urban area with developed infrastructure*". While this is a reasonable overall description, more specific detail is needed for a proper understanding of the situation. We have submitted that the assumptions should be stated in the Handbook. In summary, we suggest that the following are the key factors that influence cabling costs:

Key factor	Comment
Size of project	Several km? How many? Provision for jointing?
Amount of other underground services to work around	Telephone, cable TV, sewer, stormwater etc.
Contractual specifications	References to (national) codes
Type of cable	Construction material? Extras such as water blocking, colour marking or screens?
Requirements for reinstatement of ground	Compliance with 'Code of practice for working in the road' issued by Standards New Zealand? Testing and compaction requirements? Dumping fees?
Location of trench	Proportions in footpath, road or berm?
Surface	Type (bitumen, concrete, tiled, grass, etc).
Traffic management and safety	Best dealt with via a \$/m average cost, depending on the road traffic level (1, 2 or 3)
Trees	Presence or density. Arborist report or supervision required?
Availability of contractor(s)	
Contestability of contractors	
Timing	Period for costing (suggest average within one year)
Other works	Assume any other associated works?

The variance that has occurred with the cost estimates for cabling arises mainly from insufficient understanding or specification of these key factors. Orion's view is that the Handbook needs to state the assumptions and provide the flexibility for ELBs to adjust the costs where their situation is sufficiently different to result in a material difference in their per unit replacement costs.

Please note also, with reference to the discussion at the ODV Handbook conference, that Orion supports the concept of having "standard" replacement costs, but considers

that these must be based on actual efficient costs experienced in practice, under defined conditions, and that valuers may depart from those standard values but must disclose where and why they have done so.

## 10. Confidentiality

Orion claims confidentiality for the following items contained in this submission:

- a. All the information contained in Annex A:
  1. Table – Planned U/G works Contracts – Tendered Price (Excludes waivers)
  2. Table – Contracts 1990/91 financial year
  3. Table – Contracts 1991/92 financial year
  4. Table – Contracts 1992/93 financial year
  5. Table – Contracts 1993/94 financial year
  6. Table – Contracts 1994/95 financial year
  7. Table – Contracts 1995/96 financial year
  8. Table – Contracts 1996/97 financial year
  9. Table – Contracts 1998/99 financial year
  10. Table – Contracts 1999/00 financial year
  11. Table – Contracts 2000/01 financial year
  12. Table – Contracts 2001/02 financial year
  13. Table – Contracts 2002/03 financial year
  14. Table – Contracts 2003/04 financial year
  
- b. All the information contained in Annex B
  1. Contract 2001/39E Cable Management Agreement
  2. Contract 2002/03E Emergency stock & Long term spares
  3. Contract 2002/02E Emergency works
  4. Contract 93/21N
  5. Contract 2003/16E
  6. Contract 2003/60E
  7. Contract 2003/61E
  8. Contract 2003/69E
  9. Contract 2003/71E
  10. Contract 2003/72E

Including all the associated information related to the above contracts.

- c. All the information contained in Annex C
  - 1. Table – Connetics Ltd Results Summary 1<sup>st</sup> April 1996 to 31 March 2004
  - 2. Table – Performance Summaries Competitor Information
  - 3. Table – Connetics earnings before interest and tax for the two key divisions within Connetics

This information is of a **confidential** commercial nature and disclosure of it would be prejudicial to the commercial position of Orion and the other parties identified in these **confidential** extracts. The information contained in Annex C contains **confidential** material about the financial performance of Connetics and it seems to us unnecessary for this information to be disclosed to Parsons Brinckerhoff. This request for confidentiality is ongoing and without limitation as to time.

## **Appendix A**

Response from NERA to question 20



**REPLACEMENT COST VALUATION OF EASEMENTS  
IN OTHER REGULATORY JURISDICTIONS**

**A Report for Orion**

**Prepared by NERA**

**April 2004  
Sydney**

**Project Team:  
Greg Houston  
Elisabeth Ross**

**n/e/r/a**

**National Economic Research Associates**  
Economic Consultants

Level 6, 50 Bridge Street  
Sydney NSW 2000  
Australia

Tel: (+61) 2 8272 6500  
Fax: (+61) 2 8272 6549  
Web: <http://www.nera.com>

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## 1. INTRODUCTION

Following its recent ODV Handbook Conference on Electricity Lines Regulation, the Commerce Commission (the Commission) sought further information from Orion New Zealand Limited (Orion) on the approach taken by regulators in other jurisdictions to the valuation of easements. Specifically, the Commission requested:

***‘Please provide information on whether there are any instances, outside the gas sector in Australia, where regulators currently allow easements to be valued at replacement cost.’<sup>1</sup>***

Orion has asked NERA Economic Consulting to respond on its behalf. This note discusses the context in which various regulatory jurisdictions address the question of easement valuation and reports the outcomes of those decisions.

This note is structured as follows:

- section 2 provides an overview, with particular emphasis to the context for regulatory decisions on asset valuation; and
- section 3 sets out those examples of which we are aware that value easement or land assets at their current replacement cost.

It should be noted that, although the Commission’s request referred specifically to the valuation of easements, some regulatory decisions make no distinction<sup>2</sup> between the valuation approach to easements and that to land. Other regulatory decisions, while seeking to distinguish some characteristics<sup>3</sup> nevertheless adopt the same regulatory approach to both asset classes.

This commonality of approach is consistent with the fact that easements amount to rights over land. The value of an easement is therefore determined by the extent to which the right that it confers attenuates the wider set of rights that underpin the value of unencumbered land. For these reasons, this paper covers relevant regulatory decisions in relation to both land as well as easement assets.

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<sup>1</sup> Commerce Commission, *Electricity Lines Regulation: ODV Handbook Conference, Information to be Provided Post-Conference*, April 2004

<sup>2</sup> See, for example, the decision of the Queensland Competition Authority, discussed at section 3.1.1

<sup>3</sup> See, for example, Australian Competition and Consumer Commission, *Sydney Airports Corporation Limited, Aeronautical Pricing Proposal, Decision*, May 2001, at page 142

## 2. CONTEXT AND OVERVIEW

### 2.1. Regulatory Context

In reporting the decisions of regulators in other jurisdictions on the question of easement valuation (or any other element of regulatory decision-making) it is important to set out any relevant context for those decisions. In the case of easement valuation, relevant contextual considerations are likely to include:

- the *legal objectives* with which a regulator is bound to comply; and
- the *purpose* to which any decision on easement valuation is directed including, for example, whether the easement valuation is to be applied for decisions on *whether or not to impose price control* or, alternatively, for decisions on the *ongoing administration of a price control regime* where the imposition of control is a foregone conclusion.

The relevant context for the Commission's decisions on asset valuation, including the valuation of easements, is that:

- the regulatory regime is a 'threshold and control' regime involving two discrete steps, ie:
  - the establishment of thresholds, compliance with which carries the presumption that an electricity lines business will not be subject to price control; and
  - subsequently, decisions on whether and how to impose price control in the event thresholds are breached; and
- the purpose statement at section 57e, which sets out the objectives of the regime, including that of ensuring electricity lines businesses:

*'are limited in their ability to extract excessive profits...'*<sup>4</sup>

### 2.2. Decisions on the Imposition of Price Control

In the context of the New Zealand electricity lines businesses 'threshold and control' regime<sup>5</sup> and other similar circumstances,<sup>6</sup> NERA has previously put the view that the relevant test

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<sup>4</sup> Commerce Act 1986, S 57E

<sup>5</sup> Transcript from the Commerce Commission Conference re ODV Handbook for electricity lines regulation, 16 April 2004, pp361-362

<sup>6</sup> NERA, *The Opportunity Cost of Airfield land - A Comment on the Commerce Commission's Proposals: A Report for Auckland International Airport*, May 2002

for excess profits is the *hypothetical new entrant test*.<sup>7</sup> This test requires the adoption of an optimised depreciated replacement cost (ODRC) asset value for all assets. Unless a business is earning returns in excess of its weighted average cost of capital on the ODRC value of all its assets, it cannot be said to be earning excess profits because no other entity would be willing to provide the service on a sustainable basis at a lower price. This principle applies equally to land and easement assets as to any other asset class necessary for the provision of the relevant services.

There are relatively few circumstances in other jurisdictions where regulators are required to assess whether or not the price for supplying particular infrastructure services should be subject to control. The vast majority of regulatory decisions involve the ongoing administration of price control in an environment where its imposition has effectively been mandated<sup>8</sup>.

The Australian gas transportation sector is one significant example of regulatory decisions on asset valuation that are made by reference to whether or not to impose price control. This context arises under the 'coverage criteria' of the Australian 'gas code'.<sup>9</sup> Although the Commission did not ask for information on this example, for completeness a brief summary of relevant decisions made in this context is provided below.

The only other similar context of which we are aware is an 'access undertaking' provided by the Queensland rail access regime. This undertaking establishes ceiling prices for the terms on which third parties may access below rail services in the Queensland rail network. Easements in that context are also valued at their ODRC value.

### 2.3. Decisions on the Administration of Price Control

There are, of course, a great many examples of regulatory decisions made in the context of the ongoing administration of mandated price controls. Amongst these, easement assets are generally valued at either their original cost (in North America), or their indexed historic cost (in Australian electricity lines regulation). United Kingdom utility regulation generally also adopts an indexed historic cost approach to asset valuation, with initial assets valued by reference to privatisation proceeds. These examples are not elaborated further in this paper.

The principal examples where the administration of price setting decisions is derived using land assets (and, by inference, easement assets) valued at their replacement cost are the

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<sup>7</sup> For a comprehensive discussion of these issues see NERA, *The Hypothetical New Entrant Test in the Context of Assessing the Moomba to Sydney Pipeline Prices*, A Report for the ACCC, September 2002. See also the National Competition Council's *Final Decision, Moomba to Sydney Pipeline System: Revocation Applications Under the national Gas Code*, November 2002.

<sup>8</sup> Decisions on whether or not to impose price control for infrastructure monopoly businesses are generally the preserve of governments, rather than regulators.

<sup>9</sup> National Third Party Access Code for Natural Gas Pipeline Systems, 1997, section 1.9

telecommunications sector and the New Zealand airports sector. In New Zealand, regulatory jurisdiction for telecommunications falls under the Commerce Commission, which has established interconnection prices by means of an international benchmarking study. As discussed in the following section, the available evidence suggests that land assets were accounted for in that process at their current replacement cost.

In the New Zealand airports sector, a recent arbitration decision<sup>10</sup> before The Hon Sir Ian Barker QC confirmed the position put by Wellington International Airport (WIAL) that a replacement cost valuation of airport land assets was consistent with the airport's obligations not to engage in monopoly pricing, and that such an approach was preferred over historic cost.

In addition to the above telecommunications and airports examples, two important decisions on the administration of price controls in the Australian gas sector have adopted easement valuations based on replacement cost, ie, those made by the Australian Competition and Consumer Commission (ACCC) in relation to the Moomba to Sydney and Moomba to Adelaide pipelines. For completeness, these examples are elaborated on below.

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<sup>10</sup> Arbitration between Wellington International Airport Limited and Air New Zealand Limited, Qantas Airways Limited and others, *Final Award of Sole Arbitrator The Hon Sir Ian Barker QC*, Wellington September 2002

### 3. REPLACEMENT COST VALUATIONS ELSEWHERE

In section two, we noted that all regulatory decisions should be interpreted with careful reference to the context in which they were made. Of particular importance to the Commission in its development of the 'threshold and control' regime for electricity lines businesses is the distinction between decisions on whether or not to impose price control and those required in the administration of price controls, once mandated. The following section – which reports examples of the use of replacement cost valuations for easements - is therefore structured so as to distinguish these two contexts.

#### 3.1. Decisions on the Imposition of Price Control

##### 3.1.1. Queensland Rail: Access Undertaking

In 1999 Queensland Rail (QR) applied to the Queensland Competition Authority (QCA) for approval of its draft undertaking for third-party access to the services provided by its rail transport infrastructure. In the context of Australia's access law<sup>11</sup>, the role of an 'undertaking' is to set out the terms and conditions by which a third party may gain access to a service. In this case, the relevant service is the use of existing rail infrastructure by alternative locomotive and rolling stock operators.

In assessing a proposed undertaking, the QCA is required to consider, among other things:

- the legitimate business interests of the owner of the service; and
- the public interest, including the public interest in having competition in markets.<sup>12</sup>

This context of this particular access undertaking is similar to the threshold and control regime for electricity lines businesses in that prices are not directly subject to control. Rather, QR proposed to undertake commercial negotiations with access seekers, subject to restrictions on the terms and conditions that may be imposed, as outlined in the undertaking. Specifically, as the monopoly service provider in the rail sector, QR is prevented from charging a price that, taken together with other prices for providing the service, would exceed a 'ceiling' level of revenue. That ceiling represents the *full economic costs* efficiently incurred in providing access to a service, where such costs are assessed by reference to the optimal configuration of assets for serving the specified purpose.

In its final decision regarding QR's draft undertaking, the QCA determined that all assets, including easements, should be valued at ODRC. The QCA expressed the view that it was:

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<sup>11</sup> See Part IIIa, Trade Practices Act (1974)

<sup>12</sup> Queensland Competition Authority Act 1997, s. 138(2)

***‘not appropriate to value land at zero nor historical cost. Any attempt to value in this way would undermine the incentives to invest in the network. Historical cost assessments would substantially understate the opportunity costs imposed on society of the existence of the network, particularly as some of the land that comprises QR’s network was acquired over a century ago.’<sup>13</sup>***

### 3.1.2. Australian Gas Sector

Although the Commission asked for examples of easement valuations in jurisdictions other than the Australian gas sector, a short description of relevant decisions from this jurisdiction is included for completeness.

The regulatory framework for natural gas pipeline regulation in Australia provides for an explicit test to be met by all pipelines as to whether or not they should be subject to an access regime (or ‘coverage’, under the gas code), and so a regime of price control.

The criteria that must be satisfied for coverage to be invoked are that:

- access will promote competition in at least one other market;
- it is uneconomic to develop an alternative pipeline;
- access can be provided without undue risk to health or safety; and
- access would not be contrary to the public interest.

If a pipeline meets the criteria for coverage, the gas code provides third party access at regulated tariffs (ie, price control). The most relevant case heard and decided by reference to these criteria is that of the Moomba to Sydney pipeline, which sought revocation of coverage under the gas code in June 2001.

In its evaluation of the pipeline owner’s application for coverage to be revoked, the National Competition Council (NCC) tested the existing pipeline tariffs for the existence of monopoly profits. The NCC approached this question by formulating and applying a hypothetical new entrant test to existing tariffs. As noted in section 2, the hypothetical new entrant test requires the application of an ODRC asset value for all assets of the pipeline, including easements.

Although certain aspects of this test were disputed by the pipeline owners, East Australian Pipeline Limited, there was no dispute over the appropriate approach to asset valuation, either in general or in relation to easements specifically. The specific approach taken to easement valuation was the same as that used by the related ‘administration of price control’ decision by the ACCC, as elaborated on in section 3.2 below.

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<sup>13</sup> Queensland Competition Authority, *Final Decision on QR’s 1999 Draft Undertaking*, July 2001, p.366

## 3.2. Decisions on the Administration of Price Controls

### 3.2.1. Telecommunications Sector

A widespread approach to the regulatory determination of access or interconnection charges in the telecommunications sector is by reference to the forward-looking or long run incremental costs of providing an interconnection service.

In New Zealand, regulatory jurisdiction for telecommunications falls under the Commerce Commission. The Commission has established interconnection prices by means of an international benchmarking study of the forward-looking costs of interconnection. In deriving these prices, the Commission is required to take into account the purpose statement, as follows:

*‘The purpose of this Part and Schedules 1 to 3 is to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers.’<sup>14</sup>*

In its principles paper<sup>15</sup> the Commission sets out the reasons behind its proposal to use optimised replacement cost as the basis for its estimated asset valuation for the purposes of establishing access prices. Although not specifically mentioned, the discussion does not indicate that either land or easements would be treated differently from other assets.

In a separate and preceding paper reviewing international benchmarks for interconnection pricing, the Commission makes explicit reference to the adjustments required for differences in the cost of land when comparing forward-looking cost based prices in various benchmark jurisdictions, ie:

*‘Differences in the land and building costs, power costs, and material costs were given due consideration by the Commission in making its decision with regard to which method to use when developing an exchange rate.’<sup>16</sup>*

Although there is insufficient detail available publicly to know exactly how land costs have been factored into the Commission’s benchmarking analysis, there is no aspect of the Commission’s commentary to suggest that land or land-related assets have been treated differently from any other cost component.

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<sup>14</sup> Telecommunications Act, Part 2, 2001, section 18

<sup>15</sup> Commerce Commission (2004) *Telecommunications Act 2001 Implementation of TSLRIC Pricing Methodology for Access Determinations under the Telecommunications Act 2001 Principles Paper*, pages 33 to 34.

<sup>16</sup> Commerce Commission, *International Benchmarking Report, A Comparative Review of Interconnection Pricing*, September 2002

### 3.2.2. Wellington International Airport

The New Zealand airports sector is not subject to formal price controls. Rather, the price setting powers of airports are governed by statutory provisions that allows an airport company to

***‘set such charges as it from time to time thinks fit for the use of the airport operated or managed by it’<sup>17</sup>***

In addition, airport companies are subject to statutory requirements to consult<sup>18</sup> with ‘substantial customers’ in relation to capital expenditure and charging matters, and to the disclosure of financial performance information.

Airport charges at Wellington airport have been subject to a number of disputes with airline customers, with the appropriate approach to valuing airport land for pricing purposes being a central issue of contention. In August 2002, a dispute between WIAL and a number of airlines over the valuation of land was heard in arbitration proceedings before Hon Sir Ian Barker QC. The principal question put before the arbitrator was whether or not airport land should be valued by reference to its:

- market value in existing use (as proposed by the airport); or
- next best alternative use (as proposed by the airlines).

In economic terms, these valuation approaches are analogous to the ODRC value of land, and the scrap or exit value, respectively.

The arbitrator found in favour of WIAL’s preferred approach to valuation, thereby ratifying an ODRC or current replacement cost value for land assets. In interpreting the statutory provisions applying to airport charges the arbitrator found that the power of airports to set charges is fettered by the administrative law requirement for reasonableness, ie:

***‘the ‘landing charges’ must not be so unreasonable that no reasonable airport would levy them’<sup>19</sup>***

Further, and of particular relevance to his finding on the appropriate valuation principle to be applied, the arbitrator found that a non-exclusive manifestation of the requirement for reasonableness was that:

***‘there must be no monopoly charging’<sup>20</sup>***

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<sup>17</sup> Airport Authorities Amendment Act 1997, section 4A

<sup>18</sup> *Ibid*, section 4B

<sup>19</sup> Arbitration between Wellington International Airport Limited and Air New Zealand Limited, Qantas Airways Limited and others, *Final Award of Sole Arbitrator The Hon Sir Ian Barker QC*, Wellington September 2002, para 36

The arbitrator went on to consider the relative merits of replacement cost and historic cost valuations by reference to these principles, and found in favour of the replacement cost approach proposed by the airport, ie, ODRC. The arbitrator's finding included the statement that:

*'It cannot be an exercise in gouging monopoly profits for an airport (or any other business acting commercially) to obtain a proper return on the true value of an asset which may have been purchased at a bargain price. The profit element on any high value arises from the good bargain made by the purchasers of a company and not from the fact of the company's monopoly. If the purchases of the company bought the shares at an overvalue, the converse would be true. The true market value is what the value is at the time of valuation, not at the time of purchase.'*<sup>21</sup>

### 3.2.3. Australian Gas Sector

As for decisions in relation to the imposition of price control, although the Commission asked for examples of easement valuations in jurisdictions other than the Australian gas sector, a short description of relevant decisions from this jurisdiction is included for completeness. These examples documented below are those where replacement cost easements valuations have been accepted<sup>22</sup> by the Australian Competition and Consumer Commission.

In its most recent decision regarding transmission prices for the *Moomba to Sydney pipeline* in 2003, the ACCC based its asset valuation on ODRC and essentially accepted the pipeline owner's consultant's, Venton and Associates (Ventons), proposed optimised replacement cost, with the exception of a proposed contingency factor.<sup>23</sup> Ventons based its optimised replacement cost estimate on the capital costs associated with an *optimised system design*. This included the specific capital costs associated with procuring easements, broken into the following categories:<sup>24</sup>

- easement documentation submission;
- landowner contact/negotiations;
- land valuations;
- easement lodgement/registration; and

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<sup>20</sup> *Ibid*

<sup>21</sup> *Ibid*, para 174

<sup>22</sup> We note there are also examples from the Australian gas pipeline sector where easements have been valued at either indexed historic cost or excluded from the relevant asset base altogether. However, a full description of the context and reasons for such decisions is beyond the scope of this report.

<sup>23</sup> ACCC (2003), *Final Decision East Australian Pipeline Limited Access Arrangement for the Moomba to Sydney Pipeline System*, pages 27, 41 and 73

<sup>24</sup> Venton and Associates (1999), *Report, Optimised Design and Cost Estimate EAPL Pipeline Network*, Attachment 3.

- claims, damages and acquisition.

Similarly, in its 2001 decision regarding the transmission prices for Epic Energy's *Moomba to Adelaide pipeline*, the ACCC accepted the case put by Epic for recognising the additional costs associated with meeting native title requirements. A rate of \$5,000 per km of pipeline, as proposed by Epic, was incorporated to account for the costs of such easements.<sup>25</sup> This figure was reached as follows:<sup>26</sup>

*'The only un-quantifiable amount is the cost of settling native title compensation issues. In the recent past the cost of settling native title issues has ranged from \$2,500/km to \$100,000/km. This would add from \$2,635,000 to \$105,400,000 to the replacement value. It is suggested that a figure of \$5,000/km would be appropriate for this Pipeline System.'*

Epic's proposed easement valuation was therefore a replacement cost based valuation, although we note that the ACCC did not revise the figure of \$5,000 per km for inflation to account for the two and a half years between this estimate being made and its final decision.

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<sup>25</sup> ACCC (2001), *Final Decision Access Arrangement Proposed by Epic Energy South Australia Pty Ltd for the Moomba to Adelaide Pipeline System*, page 18.

<sup>26</sup> Epic Energy (1999), *ORC Paper Analysis of Optimised Replacement Cost for Pipeline System and Facilities*, attachment 2 to *Access Arrangement Information for the Moomba to Adelaide Natural Gas Pipeline*, page 24

## **Appendix B**

Contract management Policy

Contract Tendering Policy

Evaluation of Tenders



*NETWORK ASSET MANAGEMENT*

**CONTRACT MANAGEMENT  
POLICY**

**NETWORK  
POLICY STANDARD  
NW73.00.03**

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### AMENDMENT RECORD

Amendment No.	Page Amended	Amend Date	Date Inserted	Inserted by	Approved by
2	4	24.11.98			
3	Orion	08.03.99			

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## CONTRACT MANAGEMENT POLICY

Orion wishes to develop, promote and retain a group of competent contractors.

To achieve the best value for its contracted works Orion intends to get competitive prices for goods and services associated with work on the Network Asset, having due regard to the long term network security and work quality.

All work initiated from the Asset Management division that Orion is liable to pay for, with a value in excess of \$5,000, should only be performed after obtaining at least two prices.

All work with a value in excess of \$20,000 is to be performed as a separate tendered contract.

The lowest overall price is to be the accepted price if the contractor conforms to the lowest price conforming criteria. Otherwise the remaining lowest price may be accepted provided it conforms to the lowest price conforming criteria.

The exceptions to the above are as follows:

- Emergency Works & Major Emergency Works which may be subject to a negotiated arrangement between the parties including a fixed payment to secure adequate specialist resource.
- Emergency spares and stock storage
- SCADA and ripple works (a specialist service)
- Metering (a specialist service)

Where there is only one supplier of goods and services a decision must be made on the basis of fair value for money. It will be necessary to make comparative judgements on fair value for money by comparing costs with the costs of similar goods and services.

In some cases it may be necessary to include lifetime costs to justify a decision. Other situations may require a solution which may be the best overall technical solution that can be justified for reasons such as reliability or technical compatibility.

It will be necessary for the person ordering the goods and services to state the reason for not accepting the lowest tendered price on document NW73.10.13 and attach this to the tender file.

These exceptions will require authorisation by the Asset Manager.

*NETWORK ASSET MANAGEMENT*

**CONTRACT TENDERING**

**ELECTRICITY NETWORK  
PROCEDURE  
NW73.10.09**

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2	6, Orion	08.03.99			
3	4	09.05.00			

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## PREPARING DOCUMENTS

Determine the type of work required:

- ◆ Design.
- ◆ Build.
- ◆ Design Build.

Determine whether a Design (Consultancy) type agreement, a Construction (NZS3910) or a Purchase (FIDIC) type agreement is required.

Prepare the Contract documents using the Contract Check List (NW 73.10.12) and confirming the following:

- ◆ Contract number.
- ◆ Contract title.
- ◆ Tender closing time, date and location.
- ◆ Required Design and Technical Specifications.
- ◆ Description of work.
- ◆ Start date.
- ◆ Duration or finish date.
- ◆ Any other Tender / Contract requirements.

## CALLING TENDERS

Determine in conjunction with the Originator/Contract Manager which Contractors to invite to tender.

Prepare invitation letters; bundle with documents and post to Contractors.

Prepare "Notices To Tenderers" to clarify the documents in response to tenderers requests as required. All invited tenderers must receive clarification notices.

## CLOSING TENDERS

Tenders closing in the Tender box are to be uplifted jointly by two officers using keys obtained from the Asset Management Office Administrator and the Ground Floor Receptionist.

Tenders shall be opened and the Tenderers names and offers recorded and signed by both officers. See Appendix A.

## TENDER EVALUATION

Evaluate the tenders in conjunction with the originator of the work using the "Lowest Price Conforming Tender" method (NW73.10.13), consider any exceptions and deviations and obtain tender clarifications if required.

Notify both the successful and unsuccessful tenderers and advise the range of tendered prices.

## ACCEPTANCE OF TENDER

The successful tenderer shall be notified as stated in the Conditions of Tender.

**NOTIFICATION OF TENDER**

The tenderers shall be notified as stated in the Conditions of Tender.

**APPENDIX A**

**TENDER RECEIPT FORM**

**CONTRACT** \_\_\_\_ / \_\_\_\_ **E**  
(E=Electricity)

**TENDERS CLOSED 1:00PM** \_\_\_\_\_ **200**\_\_

TENDERER	AMOUNT (EXCL GST)
Connetics	_____
Alstom	_____
Electrix	_____
Independent Line Services	_____
Power Jointing	_____
Cherry Picker Specialists	_____
Treescape	_____
Richdale Builders	_____
Kevin McGovern	_____
Other	_____
	_____
	_____

SIGNED: \_\_\_\_\_

DATE: \_\_\_\_\_

SIGNED: \_\_\_\_\_

DATE: \_\_\_\_\_



***NETWORK ASSET MANAGEMENT***

**EVALUATION OF TENDERS**

**NETWORK  
POLICY STANDARD  
NW73.10.13**

## DISTRIBUTION REGISTER

<b>COPY</b>	<b>ISSUED TO</b>
1. (Master)	Asset Information Supervisor
2.	Asset Manager
3.	Contract & Information Manager
4.	Contract Administrator
5.	Engineering Manager Electricity
6.	Strategic Planning Manager
7.	
8.	
9.	
10.	
11.	
12.	

**AMENDMENT RECORD**

Amendment No.	Page Amended	Amend Date	Date Inserted	Inserted by	Approved by
2	Orion	08.03.99			
3	8	16.08.00			
4	6	27.03.03			

The above table lists the amended pages in this standard, which have been distributed following the initial issue of this standard. Please insert the amended pages and discard the replaced pages.

An update table is issued with each amendment. Check the new pages inserted against the table and fill out the "Date Inserted" and "Inserted By" spaces when inserting the amended pages.

Amendments are marked with a vertical line against the left margin.

## EVALUATION OF TENDERS

### LOWEST PRICE CONFORMING TENDER METHOD

Further to Clause 107.1 of the Schedule to the Conditions of Tendering the tender evaluation process shall be conducted in two stages as follows:

1. The first stage shall consist of determination of tender acceptability when assessed against each of seven non-price factors, and no others. Each factor shall be scored on a pass/fail basis. Any factor which scores a fail will exclude that tender from further consideration.
2. The second stage shall consist of the tendering authority determining which of the remaining conforming tenders has the lowest price.

#### Non-Price Factors

The seven non-price factors are:

<b>Factor</b>	<b>Definition</b>
1. Relevant Experience	The Tenderer's previous experience, particularly in technical areas relevant to the Specification.
2. Track Record	The Tenderer's record of completing projects to target, performance levels, on schedule, within budget and safely.
3. Competency and Technical Skills	The ability that the Tenderer's proposed personnel have with respect to the technical and legal requirement of the Specification. This includes appropriately trained, certificated and experienced persons for the class of work required to be done.
4. Adequacy of Safety Management Plan	The adequacy of the Tenderer's proposed Health and Safety Management Plan to meet the requirements of the HASIE Act, Electricity Act and Electricity Regulations, Resource Management Act, and all other statutory requirements.
5. Quality Assurance	The Tenderer must demonstrate developed procedures and programmes which provide quality control of work processes.
6. Customer Service	The tenderer must demonstrate a track record of commitment to the delivery of the expected specified Customer Service standards.
7. Management Skills	The ability within the Tenderer's organisation of people and systems appropriate to the successful management of the project.

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**APPENDIX A:  
Tender Assessment Check Sheet**

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**TENDER ASSESSMENT**

Issue Date 08.03.99

Amendment No.1

Nw730001.doc

Total Pages 4

**CONTRACT NUMBER :** \_\_\_\_\_

(Completed with reference to Tender Assessment Procedure  
25/3/94)

Contractor Name: 1 \_\_\_\_\_ 2 \_\_\_\_\_ 3 \_\_\_\_\_ 4 \_\_\_\_\_

1) Relevant Experience	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
2) Track Record	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
3) Competency & Technical Skills	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
4) Adequacy of Safety Management Plan	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
5) Quality Assurance	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
6) Customer Service	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
7) Management Skills	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
8) Price	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

The most suitable Contractor for the above contract is: \_\_\_\_\_

Their tendered price was \$ \_\_\_\_\_

Signed:  
\_\_\_\_\_  
Engineer to Contract

NOTES: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

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**APPENDIX B:  
Contract Tender Check List**

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## CONTRACT TENDER CHECK LIST

CONTRACT NUMBER: \_\_\_\_\_ / \_\_\_\_\_ E  
(Year) / (Contract Number)(Asset)

CONTRACTOR	1 _____	2 _____	3 _____	4 _____
Quote or Schedule of Rates	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Competent Persons	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Health & Safety	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Subcontractors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Insurance - Public Liability	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Insurance - Contract Works	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Bond	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Contractors Exceptions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Programme of Works	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>