



# **ODV Handbook Conference**

**Cross-Submission from Powerco**

**30 April 2004**



This paper provides answers to the questions asked by the Commissioners, their staff and advisors of Powerco during its presentation at the ODV Handbook Conference in Wellington on April 15. For ease of reference each question is cross-referenced to the conference transcript.

Transcript Page	Transcript Lines	Question/Clarification
278	17-27	Commissioner Bates QC:  .. the prices paid for many of the easements are not really related to the land values at all, they're higher than the drop in value.
<p>During the conference, Powerco's CEO offered to provide the Commission with a copy of advice on this issue from Mr Peter Seed. This advice is contained in Powerco's August 2003 submission to the Commerce Commission on <i>the Gas Control Inquiry Draft Framework Paper</i>. The answers to the Commission's questions 39 (How should intangible assets be valued? How do they depreciate?) and 41 (What is the replacement cost of intangible assets? How might they be optimised?) are particularly relevant here:</p> <p><i>.. by granting an easement, the landowner transfers a subset of his or her total bundle of ownership rights to the easement holder.</i></p> <p><i>Therefore, the usual method of valuing easements is to determine the allocation of the rights of occupation between the landowner and the entity seeking the easement over the land. Based on this allocation, the land value can be apportioned between the landowner and the easement holder.</i></p> <p><i>There is a sizeable body of literature on easement valuation and a number of international professional societies that advance the body of knowledge related to the professional tasks of its members. For example, the International Right of Way Association (see <a href="http://www.irwaonline.org">www.irwaonline.org</a>) has around 8,300 professional members in the United States, Canada and other countries...</i></p> <p>and</p> <p><i>... in very simple terms the replacement cost of this easement can be estimated by applying the underlying allocation rights to the current, and likely to be easily observed, market value of the land affected by the easement.</i></p> <p>We also attach a report commissioned by Powerco in October 2003 from Crighton Anderson &amp; Associates on the likely cost of acquiring the necessary easements to connect the Tararua wind farm to Powerco's network. In section 2.0 (Injurious Affection &amp; Compensation), Crighton Anderson's advice is consistent with Mr Seed's. Crighton Anderson go on to value the injurious affection compensation that would be payable by Powerco under several construction scenarios.</p> <p>Crighton Anderson's valuation approach is set out in section 2.4 and considers the difference in value of the property "before" the "works", with the value "after" the "works". This is the</p>		

valuation technique alluded to by Commissioner Bates in her question. As Crighton Anderson note in paragraph 31, where this approach is used it relies on comparable market evidence to derive a value. The table in Appendix 1 contains indicative market values for “injurious affection per metre” as a function of the market value of the land, the length and width of the easement corridor, the height and number of the poles, number of corridors. These parameters yield a percentage of the dwelling lost to the easements and thus a percentage of the property rights in the land that are associated with the easement. The “injurious affection per metre” is therefore the market value of the land multiplied by the percentage of property rights so calculated.

In Crighton Anderson’s advice to Powerco it is clear that easement valuation is directly proportional to the market value of the land over which the easement is granted – in answer to Commissioner Bates’ question the drop in land value due to injurious affection is identical to the value of the easement.

The Crighton Anderson report is a working document, produced to inform Powerco during a real situation in last year’s network planning process. In this example, two easement corridors are proposed to connect the proposed Tararua Windfarm to both Transpower and Powerco’s networks – in one case easements are a direct substitute for poles and wires. This is the point made by Mr Horton (transcript pp. 259 to 260). Because of the difference between the cost of access, there will be cases where the total cost of a line built on a direct route will be higher than that of a line built on a longer route which avoids private land, even though the cost of poles and wires in the latter case is higher. As Mr Horton’s notes at pp. 275-276 under a replacement cost valuation methodology such as ODV, easement values must be derived from observations of market prices.



<b>Transcript Page</b>	<b>Transcript Lines</b>	<b>Question/Clarification</b>
286-287	30-4	Commissioner Bates QC:  Are the easements that have actually had to be paid for are .. where lines are traversing a person's land going somewhere else?
<p>Yes. In general it is not necessary to pay for easements for feeders that are dedicated to one customer and cross that customer's land. In some cases easements are purchased where a feeder is shared between several customers – including the landowner from whom the easement has been purchased.</p>		



Transcript Page	Transcript Lines	Question/Clarification
297	20-28	<p>Commissioner Bates QC:</p> <p>Does the Electricity Amendment Act 2001 effectively provide ELB's with the right to upgrade lines without easements?</p>
<p>The Electricity Amendment Act 2001 amended section 23 of the Electricity Act 1992 by adding a definition of maintenance. Section 23(3) states that 'maintenance' includes:</p> <p style="padding-left: 40px;">any repairs and other activities for the purpose of maintaining, or that have the effect of maintaining, existing works; <b>and</b></p> <p style="padding-left: 40px;">the carrying out of any replacement or upgrade of existing works as long as the land will not be injuriously affected as a result of the replacement or upgrade.</p> <p>It also added new sections 23A to 23E which govern the provision of notice by a line owner prior to entry onto land, and permit the land owner to set reasonable conditions on entry.</p> <p>The effect of the amendment for present purposes is simply to make it clear that lines companies may rely on their pre-1993 rights to replace or upgrade lines. It avoids any misunderstandings as to what is meant by "maintenance". This is permitted as long as the land is not injuriously affected in doing so. While the legislation is not explicit on this point, it appears that if injurious affection does result, then the lines company is not permitted to rely on its pre-1993 rights. Rather, a formal easement must be sought.</p> <p>The problem with the section 23(3) definition is that even a relatively minor impact on a landowner's use or enjoyment of the property, can lead to the assertion that the land has suffered a loss of value and therefore had been injuriously affected, with the result that existing works cannot be replaced or upgraded in reliance on section 23.</p> <p>Powerco has previously argued that section 23 should be amended to provide for a <i>substantial</i> injurious affection test (i.e. existing works can be replaced or upgraded provided that the land would not suffer substantial injurious affection). This would allow relatively minor replacement or upgrade works to be undertaken with some certainty that entry on to land for this purpose will not be able to be challenged on the grounds that <i>some</i> limited injurious affection has been caused.</p> <p>Upgrade and replacement works may well have a net overall benefit in terms of impacts on landowners generally along a route, but individual landowners can still assert at present that their properties have been injuriously affected even although the impact is very slight.</p> <p>If a landowner suffers less than substantial injurious affection (the test proposed by Powerco), he or she would be entitled to compensation under section 57 of the Electricity Act. Powerco considers such a test better balances the respective rights of landowners and lines companies in respect of existing works. Any net impact on landowners can be compensated for, without there being the need to negotiate with landowners along a route with the prospect of "<i>hold out</i>" by one or more of them.</p>		



Regarding the case *Counties Power Ltd v Croudts & Ors* (unreported, Pukekohe District Court, NP 182-96, 29 August 1996, Judge Cadenhead) referred to by Commissioner Bates at page 291, lines 29-32 of the Transcript, Powerco considers that this decision of the District Court regarding the parameters of “maintenance” is open to question, and in any case has been superseded by the 2001 amendments to section 23.

Transcript Page	Transcript Lines	Question/Clarification
297-298	31-5	Mr Gibbons:  What was the process under Section 94 of the Power Boards Act for affected land owners to gain compensation?
<p>Section 94 provides that the manner by which affected land owners were to gain compensation was that set out in the Public Works Act 1908 (“<b>the 1908 Act</b>”), and subsequently the Public Works Act 1981 (“<b>the 1981 Act</b>”). The Public Works legislation is long and detailed. Only the most straightforward process is outlined here.</p> <p>The process to be followed in making a claim for compensation is:</p> <ul style="list-style-type: none"> <li>• The claim can be made by the owner of the land, whether or not it is the owner that has the power to sell and convey the land, or an executor or administrator;<sup>1</sup></li> <li>• A claim cannot be made more than two years after the date of the Proclamation or declaration taking the land, the execution of the works, or the exercise of power out of which a claim has arisen.<sup>2</sup> Under the 1928 Act, it was five years after taking of land or 12 months after execution of works, but this was later able to be extended;</li> <li>• The Minister of Lands or the local authority can apply to the Land Valuation Tribunal for a determination of compensation, if the person with the right to claim compensation has not made the claim;<sup>3</sup></li> <li>• There are procedures for speeding up the hearing of compensation claims where the Minister or local authority has issued the notice of intention, the execution of the works which have injuriously affected the land have been completed, or an agreement has been reached regarding the taking of land and compensation is being assessed under Part V;<sup>4</sup></li> <li>• The Third Schedule to the 1981 Act provides for forms for compensation claims to be served on the Minister of Lands or local authority;<sup>5</sup></li> <li>• Serving of claims is provided for in section 83, and any time after the expiration of 30 days after the service under section 83, the claimant or respondent may file a copy of the claim and a notice set out in the Fourth Schedule of the 1991 Act saying he or she requires the claim to be heard in the District Court.<sup>6</sup></li> </ul> <p>The basic considerations in the assessment of compensation are provided for in section 62 of</p>		

<sup>1</sup> Section 77.

<sup>2</sup> Section 78.

<sup>3</sup> Section 79.

<sup>4</sup> Section 80.

<sup>5</sup> Section 82.

<sup>6</sup> Section 84.

the 1981 Act (and section 42 of the 1928 Act). They are:

- No allowance is made for the land being taken compulsorily;
- The value of the land is that which “the land if sold on the open market by a willing seller to a willing buyer on the specified date might be expected to realise” unless the assessment of compensation relates to a matter not directly based on the value of land, or only part of the land is taken or acquired and there is no general demand for that part of land;
- In the latter case, compensation is assessed by determining the market value of the whole, and deducting the value of the owner’s land after the taking or acquisition;
- The impact of the work on the land, whether increasing or decreasing the value, is taken into account;
- Any increase in market value of land that is injuriously affected because of the taking of the land or the value of other land in which the claimant has an interest caused before the specified date by the work or the prospect of the work shall be deducted from the total amount of compensation.

Sections 63 and 64 provide for compensation for injurious affection where no land is taken. They state:

**63. Compensation for injurious affection where no land taken—**

(1) Where—

(a) Substantial injurious affection to a person's land is caused by the construction (but not the maintenance or operation) of a public work; and

(b) The injurious affection is not caused by changes of traffic flows arising out of the opening of any new road or motorway or the widening, upgrading, or deviation of an existing road; and

(c) There would exist a right of action at common law in respect of the injurious affection by the owner of the land against the Crown or the local authority, as the case may require,—

the [Crown (acting through the Minister)] or local authority shall compensate that person to such extent as the injurious affection warrants.

(2) In determining the existence of any right of action for the purposes of subsection (1)(c) of this section, the existence of any statutory authority or immunity that may be available to the [Crown] or local authority shall be disregarded.

(3) The provisions of this section shall not apply where construction of that part of the public work which causes the injurious affection has been commenced before the claimant acquired the land that is injuriously affected.

**64. Compensation for injurious affection to be assessed by reference to whole work—**

Where land is taken or acquired from any person for the purpose of constructing any [public] work which is to be situated partly on that land and partly on other land, compensation for injurious affection of the land retained by that person shall be assessed by reference to the effect of the whole of the [public] work on the land so retained and not only to the part situated on the land taken or acquired

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<sup>7</sup> See The Laws of New Zealand “Compulsory Acquisition and Compensation”, para. 88.



from that person.

It is noted that where no land is taken, a claim for injurious affection can succeed only where the act that caused the damage is one which would have given a right of action if it had not been authorised by an Act of Parliament.<sup>7</sup>

Transcript Page	Transcript Lines	Question/Clarification
298-299	6-17	Mr Gibbons:  The ENA submitted that system line lengths had reduced over time. Is there any evidence of farmers purchasing back easement rights where lines have been removed?

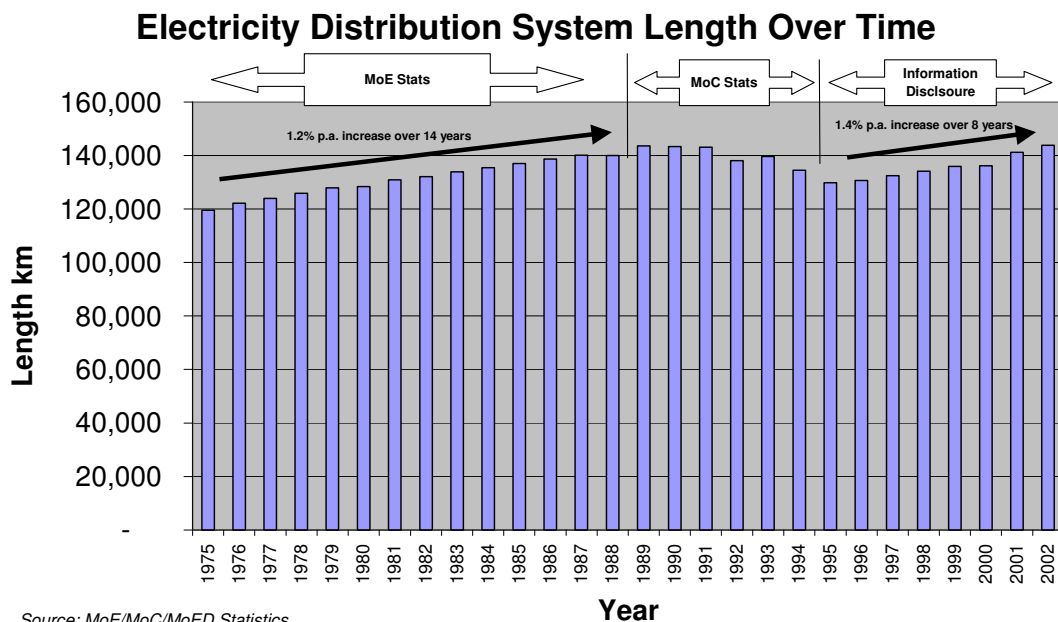
Powerco can find no evidence of instances where lines have been removed from private property and the land owner has purchased back the easement rights. In fact for all cases where Powerco lines have been removed, we have not been able to identify any situation where there was an easement registered against the land title in existence.

It is possible that a landowner would buy back easement rights from a lines business where lines had been removed if the easement was needed for another purpose but this is unlikely.

It may be nonetheless be helpful to provide some comment on ENA's submission that line lengths have reduced over time.

We understand that the ENA analysis to support this observation goes back some considerable length of time. As such we would caution against relying on the observation of trends across changing reporting regimes, where interpretation of statistical and information disclosure requirements may lead to inconsistencies.

This can be demonstrated by the examination of reported values of system network lengths over the period 1975 to 2002.



The above chart plots 'Total System Length' per annum (at year-end) over that period.

Several points may be noted from this chart:

- During the period 1975 to 1987 statistics were collected by the Ministry of Energy

by means of the 705 Returns. These were published by MoE in as “*Annual Statistics in Relation to Electric Power Operation in New Zealand*”.

- This period exhibits a steady growth of 1.2% per annum over that period.
- The period from 1989 to 1994 is more erratic but shows an apparent decline in system length.
- During this period the responsibility for the collection of statistical data passed to the Ministry of Commerce (Energy Policy Group – Energy and Resources Division).

At some point during this period the collection medium changed from a hardcopy form to an electronic system where data was entered directly into a database.

It is possible that ENA’s data about system lengths reflects changing classification regimes (or improving asset register data in the lines businesses) rather than any physical change.



Transcript Page	Transcript Lines	Question/Clarification
299	26-31	Mr Sell:  If easements were to be revalued at replacement cost, would you bring that in as income?
<p>The question wrongly assumes that easements already exist in the asset base. If easements were to be added to they would create a restatement of the asset value (rather than a revaluation).</p> <p>Mr John Hagen, one of Powerco's expert witnesses at its presentation to the Commission's Review of Asset Valuation Methodologies conference on 25 November 2002 drew a clear distinction between the correct accounting treatment of revaluations (which affect the income statement), and restatements (which are not profits). The context of Mr Hagen's comments at that conference was "found assets" – that is to say valuation increases due to assets added to an asset register since the last (incorrect) valuation at which time the lines business was not aware of them.</p> <p>In the context of ODV, valuation changes due to any of:</p> <ul style="list-style-type: none"> <li>• Found assets;</li> <li>• New asset types not included in previous versions of the handbook; and</li> <li>• Corrections to standard values in the ODV Handbook</li> </ul> <p>would all result in a restatement of the asset value – not revaluations. Changes in asset value for these reasons would not therefore be reflected in the revaluation reserve.</p>		



<b>Transcript Page</b>	<b>Transcript Lines</b>	<b>Question/Clarification</b>
300	1-32	Mr Mlandenovic  Is there any guidance from the accounting profession on the treatment of easements as tangible or intangible assets?
<p>Powerco has requested a filenote from Deloitte Touche Tohmatsu (Powerco's auditors) on how the accounting profession classifies easements. We hope to file this with the Commission next week under separate cover so as not to delay this cross-submission.</p>		

Transcript Page	Transcript Lines	Question/Clarification								
329	14-23	Mr Phillips: What percentages of Powerco's lines are light/medium/heavy?								
<p>By circuit length, Powerco's network is:</p> <table border="1" data-bbox="512 656 1120 875"> <thead> <tr> <th></th> <th style="text-align: center;">%</th> </tr> </thead> <tbody> <tr> <td>Light</td> <td style="text-align: center;">68.3</td> </tr> <tr> <td>Medium</td> <td style="text-align: center;">23.1</td> </tr> <tr> <td>Heavy</td> <td style="text-align: center;">8.6</td> </tr> </tbody> </table>				%	Light	68.3	Medium	23.1	Heavy	8.6
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341-342	17-19	Why do Powerco's costs appear to be higher than those presented by PWC on behalf of 19 ELB's?
<p>This question was raised in the context of the line replacement costs discussed in Powerco's presentation. The difference between Powerco's costs and those presented by PWC (or PB – supporting the draft ODV Handbook) could simply reflect classification differences.</p> <p>The Commission has not revealed the data supporting its draft ODV Handbook which makes it impossible to explain the difference (or similarity) between Powerco's costs and costs which are similar to those in the Handbook. Under confidentiality we attach a breakdown of Powerco's replacement costs for overhead asset groups. To allow us to compare and explain the differences between Powerco's costs and the draft ODV Handbook it will be necessary for the Commission to disclose comparable information supporting its proposed replacement costs.</p> <p>Nonetheless we make some general observations on cost levels: within the categories of heavy, medium and light line are bands of different conductor size. Within these bands, the costs can vary depending on the conductor sizes and pole spacings considered. The selection of conductor sizes and pole spacings in Powerco's project costings were in the middle or low ends of the ranges. Powerco's costings are certainly lower than those incurred by other lines businesses.</p> <p>In our submission on replacement costs and lives (November 2003) we describe the process used to collate and derive the replacement costs. In summary, we gather the costs for a range of competitively tendered recent projects involving different asset classes. We adjust these to accommodate for differences in project scope and conditions such as terrain, urban versus rural locality, scale of construction. These are then compared with project cost estimates prepared by internal engineering and contract teams.</p> <p>Both Powerco's processes for determining replacement costs and the costs themselves were independently reviewed as part of our submission. Powerco's replacement costs represent what we actually pay. It is possible that the costs presented by other parties do not.</p>		