

## **SUBMISSION TO COMMERCE COMMISSION**

### **Asset Valuation Methodologies for Electricity Line Businesses' System Fixed Assets**

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11 November 2002

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#### **INTRODUCTION**

1. The Lines Company is a party to the submission prepared by PricewaterhouseCoopers.
2. We agree with the conclusion of that submission supporting the continued use of ODV for both opening and ongoing asset values and rejecting any move towards Historical Cost.
3. This submission is solely concerned with question of excess profits arising from the use of odv valuation on a forward basis and we submit that using outlying prices at the threshold level with odv used at the control level would ensure that excess profits were not captured by the industry.

#### **CURRENT VALUATION**

4. There is an assumption within the Commission's discussion paper that electricity lines assets are currently valued at ODV. That assumption is not accurate. The essence of ODV is that values are altered annually to reflect inflationary changes. Those revaluations have not occurred. The valuations in the current version of the ODV handbook have not changed since the first draft of the handbook was published in 1992. Consequently, as shown by the table in the PriceWaterhouseCoopers submission, the current values of many components in the handbook are 20% to 30% below their true value. This difference would be consistent with inflation over this ten-year period.

5. However the size of this differential between actual odv values and current book may give rise to excess profits arising from the resulting revaluation.

### **EXCESS PROFITS**

6. Pricing against ODV requires that revaluations arising from inflationary changes be regarded as revenue and prices adjusted accordingly. Over the lifetime of an asset the same return will be produced from an asset whether it is valued at DHC or at ODV as long as inflationary adjustments are treated as revenue.
7. The revaluations that have occurred to date have not been due to inflationary changes. Instead they have been due to inaccuracies in the database, of one form or another. Had those inaccuracies been absent from the 1994 database then no revaluations would have occurred. Pricing theory does not require that customers be compensated for such revaluations as, in fact, the errors of timing have been largely to the customers' advantage in lowering revenue in the initial years.
8. An adjustment of odv values of 20% plus to reflect cost increases since 1992 should however be compensated for in pricing. If it is not then there is a capture of excess profits by the line companies.
9. One-off or forward compensation would however ignore the fact that some line companies have, setting aside the above effect of revaluations driven by data inaccuracies, been pricing below a commercial wacc. Others have not. It is inequitable to impose the same restrictions on those companies whose pricing in effect compensated for the underlying inflationary increases, as those companies who have priced to return a full commercial wacc, as in the former case excess profits have not been earned.
10. If odv values were used as a part of the threshold regime then either those companies who have had lower prices over the past ten years would be penalised

or those companies who have priced at a full level would be advantaged by being allowed to earn excess profits.

11. The most likely companies to capture excess profits from a revaluation are those whose prices on a density basis are the high outliers.
12. Using price comparability, adjusted for density, as the primary threshold would identify those companies most likely to earn excess profits. As part of the control assessment process past returns could be examined and prices controlled if the combination of past and existing prices were at levels that would give rise to excess profits. Given the size of the revaluation increase it is likely that compensation would have to be spread over a number of years through the equivalent of Transpower's eva adjustment system. Price control may have to be imposed until the full compensation for the revaluation had been accounted for.
13. We therefore submit that asset valuation should only be for control and not for threshold purposes.