

18 November 2002

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Dear Sebastian,

## **ElectraNet SA Easement Value for Final Revenue Cap Decision**

This letter addresses a number of important points relevant to the value of easements allowed in the ACCC's final revenue cap decision for ElectraNet SA (as discussed at our meeting on 12 November 2002).

### **The ACCC does have discretion to vary the value of easements included in the jurisdictional asset valuation and must exercise this discretion**

The South Australian Government (Department of Treasury and Finance) wrote to the ACCC on 10 August 2001 on the subject of ElectraNet SA's regulatory asset base and made the following statements:

*"Easements were incorporated into the RAB at book value (i.e. \$3.1m) as asset valuations consistent with the approach set out in the ACCC's draft Statement of Principles for the Regulation of Transmission Revenues dated 27 May 1999 had not been undertaken. Independent valuations of the transmission easements suggest a substantially higher value than \$3.1m"*

*"Treasury and Finance agrees that the ACCC has some discretion to amend the RAB".*

The letter notes that the Code allows for assets to be valued at a value "...consistent with the regulatory asset base established in the participating jurisdiction" (Department of Treasury and Finance emphasis)

Based on a significant amount of legal opinion, including from Stephen Gageler SC, the ACCC wrote to ElectraNet SA on 6 March 2002 in response to the question of "*whether the Commission is prepared to allow adjustments to ElectraNet's asset base to make further provision for easements and interest during construction*".

In relation to easements the ACCC advised that:

*"While the South Australian Government has made provision for easements using book value, this does not appear to represent a judgement that book value is the appropriate methodology for the valuation of easements. Rather it appears to simply be the result of time pressure. The statements by the South*

*Australian Government made in 1999 (and confirmed in 2002) indicate that it had not rejected the principles in the DRP; rather, it simply did not have time to apply these principles before finalising the RAB.*

*In these circumstances, it appears to be more accurate to say that no judgement has been made on the methodology for valuing easements. In the light of this, the Commission is of the view that it can depart from the South Australian Government's valuation of easements at book value for the purposes of determining the value of ElectraNet's sunk assets under s 6.4.2 of the Code".*

The ACCC has thus confirmed that it can depart from the South Australian Government's valuation of easements in the final revenue cap decision and the draft decision acknowledges this point.

Our legal advice (Phillips Fox) is that given the ACCC has discretion to adjust the easement value then it must exercise that discretion consistent with the objectives and principles set out in the Code.

**ElectraNet SA requests that the ACCC adjust the opening RAB in its final decision to include \$27.5m at 1 July 2001 for the fair and reasonable cost of easement compensation**

In its draft decision the ACCC notes:

*"The South Australian authorities stated that they were unable to apply the DRP owing to inadequate time. Hence it is reasonable to suggest that they would have valued easements on the basis suggested by the DRP, if they had the time*

*In the DRP the Commission stated that a consistent approach to easement valuation would be to provide compensation for actual amounts paid".*

However, this is not our understanding of the DRP. In its SPI PowerNet draft decision the ACCC states that:

*"According to the DRP a replacement cost methodology should be used when valuing easements... However, in recent decisions... the Commission has adopted a historical purchase cost rolled forward using CPI as the index" (p44).*

Notwithstanding the methodology proposed in the DRP, the ACCC is insisting that easements should only be valued on the basis of the actual amounts paid.

The draft decision has used an easement value of \$3.1m consistent with what was allowed in the jurisdictional asset valuation. However, the draft decision acknowledges that:

*"... given the explicit written qualifications by the South Australian Treasury and Finance Department the Commission may have to exercise the discretion to consider other options".*

The \$3.1m easement valuation is clearly inadequate and the ACCC's requirement to provide evidence of actual costs or receive no recognition for easement value is unreasonable. There are alternative ways to implement a historic cost approach in the absence of historic cost records.

As noted in our submission on the draft decision, the South Australian Minister for Energy in a letter to the ACCC dated 5 September 2002 states:

*"It is recognised that there is a need to include a fair and reasonable value of the easements in the asset base."*

The Minister continues that in the absence of historic cost data:

*"the South Australian Government proposes that the ACCC adopt an approach that discounts the easement values in Victoria for the difference in real estate values, and values the easements in South Australia accordingly."*

Our submission on the draft decision included a paper that develops a fair and reasonable value for historic easement compensation costs of \$27.5m at 1 July 2001, based on the approach proposed by the Minister (compared to \$79.7m allowed in Victoria – ElectraNet SA has a line length of 5,576 km compared to 6,552 km in Victoria).

This figure is derived from historic costs recognised by the ACCC in its draft decision for SPI PowerNet, the relative number of easement ownerships and ABARE derived rural price indices.

The ACCC should adjust the opening RAB in its final decision to include \$27.5m at 1 July 2001 for the fair and reasonable cost of easement compensation

**ElectraNet SA is entitled to compensation for the value of easement acquisition or transaction costs**

We made it clear in our response to the Meritec Opex Review that the jurisdictional asset valuation includes no recognition of easement acquisition or transaction costs. The draft decision does not recognise this point despite the following statements provided by Sinclair Knight Merz (SKM) who carried out the jurisdictional asset valuation.

*SKM's project manager for the 1998 Electranet valuation review was Mr Kerrod Beaton, who is still engaged by the company, and is actively involved in transmission line valuations for transmission companies across Australia. Mr Beaton is also involved in the continuous updating of the SKM asset valuation database, and has recently confirmed that no elements of easement acquisition or route selection costs are included, or were ever included in SKM valuations.*

*SKM can categorically and unequivocally confirm that its transmission line asset valuation database does not include any elements of route selection or easement acquisition costs. The database is constructed on the clear assumption that the transmission line is to be constructed on an existing easement.*

*If the SKM valuation of 1998 is considered to be the jurisdictional asset valuation, then we can confirm that all aspects of route selection and easement acquisition costs are excluded."*<sup>1</sup>

SKM has stated unequivocally that its transmission line asset valuation database does not include any elements of route selection or easement acquisition costs and that all aspects of these costs were excluded from the 1998 valuation.

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<sup>1</sup> "ElectraNet SA Asset Valuation Review", SKM File Note, 8 June 2002.

Easement acquisition or transaction costs are not related to real estate values and replacement costs are expected to be a good proxy for indexed historic costs. Meritec recommended \$36m be introduced to the RAB to recognise easement acquisition costs based on a valuation by Maloney Field Services in 2000. A more recent and comprehensive valuation by SKM suggests a higher value of \$54m (figure in Meritec report).

The ACCC has discretion to allow these costs, however, the draft decision makes no allowance for them.

### **Conclusions**

The ACCC has confirmed that it does have discretion to vary the value of easements included in the jurisdictional asset valuation and, therefore, must exercise this discretion to recognise an appropriate value for easement compensation and acquisition costs.

ElectraNet SA requests that, as a minimum, the ACCC adjust the opening RAB in its final decision to include \$27.5m at 1 July 2001 for the fair and reasonable cost of easement compensation, based on the approach proposed by the South Australian Minister for Energy.

Please don't hesitate to call me on 08 8404 7983 if you would like to clarify or discuss any aspect of this letter.

Yours sincerely,

[Sgd] Rainer Korte

Rainer Korte  
**MANAGER REGULATION**