



ISSUES PAPER: THE REVIEW OF ASSET VALUATION METHODOLOGIES

The Commerce Commission (the “Commission”) is undertaking a review of asset valuation methodologies (the “review”) under Part 4A of the Commerce Act 1986 (the Act). The Commission has prepared some questions to assist initial submissions to the review. Submitters should not feel constrained in raising additional issues not covered by the questions. The Commission wishes to consider all issues relevant to the review. When answering the questions, the Commission requests that submitters explain the rationale for why a particular view is taken.

The Purpose and Context of the Review

Part 4A (ss 57ZD and 57ZE) requires the Commission to carry out the review. In contrast to the other subparts of Part 4A (developing a price control regime (including thresholds); an asset recalibration audit; and information disclosure), which each have their own purpose statements,¹ the purpose of the review is not stated in Part 4A. The Commission will, however, have regard to the overall purpose of the Commerce Act, which is “to promote competition in markets for the long-term benefit of consumers within New Zealand”.²

The Commission considers the review could assist in formulating disclosure obligations, conducting thresholds assessments and operating control, and that it should have the appropriate valuation methodology or methodologies for these tasks. Specific questions are:

- 1. What should be the purpose(s) of the review, having regard to the purpose of the Act and the purposes of the other subparts under Part 4A?*
- 2. Can one valuation methodology be used for different purposes (e.g. comparative benchmarking and assessments of electricity lines businesses against control thresholds) or are different valuation methodologies best used for different purposes?*
- 3. What assets should be valued (e.g. the entire business, a business unit, a regional business unit)? Does the reference to “system fixed assets” in the Act mean that the definition in the Electricity (Information Disclosure) Regulations 1999 should be used for the review?³ Does it mean that only specialised assets (or sunk assets) of electricity lines businesses are covered by the review?*

¹ Sections 57E, 57T(1), and 57X.

² Section 1A.

³ Section 57ZD.

4. *How important is it that the valuation methodology used in the electricity industry be consistent with approaches in other industries? What matters should be treated consistently? What matters should be treated differently?*

Asset Valuation Methodologies

There are various economic and accounting arguments to be considered in evaluating the different valuation methodologies. The weight given to each of those arguments will depend on the circumstances. Practical issues, such as the feasibility and cost of implementation, also have to be considered (e.g. the costs of altering or developing record keeping systems).

5. *What valuation methodologies should be considered by the review?*
6. *What are the underlying economic and accounting rationales for each methodology? Are these rationales relevant for electricity lines businesses?*
7. *What are the pros and cons of each valuation methodology? How important are these in the context of the regulation of electricity lines businesses?*
8. *What are the information requirements of each valuation methodology? What detail of information is required? How accurate and robust is the information likely to be? What are the costs of developing and obtaining it?*
9. *How might different valuation methodologies (in conjunction with the regulatory controls) affect the incentives and ability to invest of electricity lines businesses?*
10. *Can valuation methodologies impact on the pricing of electricity line business services? If so, what relevance does this have for the choice of valuation methodology?*
11. *How important are the types of assets, such as specialised (or sunk assets) and non-specialised assets, to the choice of valuation methodology?*
12. *On what basis would optimisation of electricity line businesses assets be an appropriate feature of asset valuation? How should optimisation be interpreted (e.g. modern equivalent assets, removing redundant assets, removing assets that are not used or useful)? With which asset valuation methodologies can optimisation be used, and why?*
13. *How successful has the ODV methodology been at facilitating comparative benchmarking of electricity lines businesses?*
14. *What is the relevance of the ODV Handbook to the review? Does the current ODV Handbook encourage sound application of the principles of ODV? If not, how could the ODV Handbook be improved? Should a similar handbook be developed if another methodology is preferred?*
15. *What would be the transition costs of changing from ODV to a refinement of the ODV methodology or to an alternative valuation methodology?*
16. *What lessons from overseas (in the electricity industry and other industries) should be considered in the choice of valuation methodology?*

Other Considerations

- 17. Do the prices at which electricity assets have traded in the market (e.g. in takeovers or acquisitions) have any relevance for the choice of valuation methodology?*
- 18. Should the size of an electricity lines business affect the choice of valuation methodology?*
- 19. Should the ownership structure of an electricity lines business (e.g. public company, private company, or trust) affect the choice of valuation methodology?*
- 20. Should valuation methodologies differ for assets that are the subject of explicit service contracts and assets that are not?*
- 21. Should valuation methodologies differ for assets that are currently in service and those that are not yet in service?*
- 22. How should valuation methodologies treat assets that may be used (in part) for purposes other than conveying electricity (e.g. telecommunications) or in non-controlled electricity activities?*
- 23. Should asset valuations be audited? If so, how should this be done and by whom?*
- 24. Are there any other matters that should be considered by the review?*

If you wish to make a submission on the Issues Paper, the Commission would appreciate you providing an electronic copy together with 15 hard copies.

The Commission will provide further details of its timeframe for the review in due course. Should you have any questions regarding the review, please contact Peter Alsop, Manager, Network Performance, on (04) 498 4721.

Thank you for your assistance. The Commission looks forward to your input into the review process.