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Mr Alan Tregilgas
Commissioner
Utilities Commission
9th floor Cavenagh House
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Dear Mr Tregilgas

RE: NETWORKS PRICING: ASSET VALUATION OFF-RAMP DRAFT DECISION

Treasury offers the following submission in response to the *Networks Pricing: Asset Valuation Off-Ramp Draft Decision* (the Draft Decision).

Treasury accepts an underlying principle of the Commission's Draft Decision that the use of the Depreciated Optimised Replace Cost methodology to determine asset values for regulated businesses may not be appropriate in all circumstances, and that a pragmatic approach to determining the initial regulatory asset base may be warranted in some situations.

However, given the scale of the proposed write down in regulatory asset values for the Power and Water Corporation's regulated network assets, Treasury contends that the Draft Decision engenders a significant degree of regulatory uncertainty and risk, with the potential for adverse implications for future investment in regulated infrastructure, and as a consequence, the future reliability and security of supply of regulated network services. The fact the Depreciated Optimised Replace Cost methodology was adopted for the first, and initially the second, regulatory resets underlies these concerns.

This is particularly pertinent given that the degree of measurement error contained in the reported value of the Power and Water Corporation's regulated network assets, provided for the 2004 Regulatory Reset, is yet to be determined with any degree of precision or independent oversight, and in terms of the relatively compressed timeframe provided for public scrutiny of the Commission's Draft Decision.

Treasury notes that section 4(b) of the Draft Decision indicates that the most appropriate conceptual approach would have included a roll forward of the RAV at 1 July 2002 for each subsequent year after adjusting for inflation, asset acquisitions and disposals and annual depreciation.

Given the concerns outlined above and assuming that the methodology underpinning the Draft Decision is adopted, the Final Decision should make it explicit that the RAV to be established by 31 March 2005, notwithstanding any adjustments made prior to 30 November 2005 due to possible quantification errors, will be adopted permanently as the basis for the roll forward approach for determining the RAV for any subsequent determination of network price z factors in the future.

Finally, Treasury objects to the Commission's statement at paragraph 5.28 of the Draft Decision, which notes that the Government's decision to not fully fund the uniform tariff Community Service Obligation, as determined by the 2004 Regulatory Reset, provides justification for the Commission's draft finding regarding the conceptual error inherent in the use of the DORC methodology.

The decision to maintain the level of Community Service Obligation funding in real terms for 2004-05 was made in response to the uncertainties, highlighted by the Utilities Commission, surrounding the network asset values reported for the 2004 Regulatory Reset. Accordingly, Community Service Obligation funding was maintained in real terms for 2004-05 pending clarification and resolution of these matters, and not in recognition of Government's intent regarding rates of return on sunk network assets.

Yours sincerely

JENNIFER PRINCE
Under Treasurer

March 2005