# MAJOR ELECTRICITY USERS' GROUP

12 August 2009

Philippe Laspeyres
Network Performance Branch
Commerce Commission
By email to electricity@comcom.govt.nz

Dear Philippe

**Submission on 2009/10 Non-Part F Capital Expenditure for Transpower**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission discussion paper[1], "2009/10 Non-Part F Capital Expenditure for Transpower," published 29th July 2009 and supporting report by Strata Energy, "Review of Transpower's Capital Expenditure Plans (Asset Replacement, Refurbishment & Enhancement and Information Services & Technology) June 2009. The Commission propose a budget of $189.6m for 2009/10 non-Part F capital expenditure[2]. This is a 10% reduction on the $209.6m budget proposed by Transpower.

2. The Commission reports that Transpower's performance to date has not been satisfactory and acknowledge the proposed 10% reduction is conservative, that is not as onerous as a budget set on expected costs (underlining for emphasis inserted by MEUG):

   - (paragraph 16) "One of Strata's key findings is that Transpower's proposed threshold does not fully comply with the obligations and processes set under the settlement. The settlement requires that Transpower 'has proactively pursued and implemented process improvements' targeting least-cost objectives. Although some process improvements have been made by Transpower to strengthen project planning and to target 'least cost' objectives, Strata advised the Commission that Transpower's process improvements have yet to yield significant cost reductions. Strata also noted that the process improvements are not complete, particularly in respect of replacement and refurbishment expenditure."

   - (paragraph 25) "The Commission also considers that, given Strata's advice that projects going through Transpower's complete validation and approval process show, on average, efficiency gains of at least 5%, a 2.5% downward adjustment on those projects that have not been through this process is also reasonable and conservative. Transpower's level of forward planning of projects has been below that which is desirable, particularly in relation to the low proportion of projects subject to Transpower's own validation processes."

[1] Refer http://www.comcom.govt.nz/IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/transpowerintentiontodeclarecontrol.aspx#1231
[2] The $189.6m may be adjusted to $185.6m if the Bunnythorpe-Wanganui B line replacement proposal is reclassified as Part F Capex.

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- (paragraph 26) "As noted above, the threshold is intended to provide Transpower a level of discretion and allow it to exercise its role as a prudent and dynamic grid planner. The threshold sets an overall expenditure amount that Transpower should not exceed. Transpower retains discretion to prioritise, defer, bring forward, add or remove projects so long as the total capital expenditure does not exceed the threshold. Transpower has, however, failed to justify the inclusion of projects year after year, which are not undertaken. The Commission is therefore of the preliminary view that the certain projects will not be undertaken in the 2009/10 year, and that the 6% adjustment recommended by Strata for rollovers is somewhat conservative."
- (paragraph 28) "The Commission also notes that Transpower has under-spent against all of its three previous capex thresholds. In the 2008/09 year, the under-spend was significant. It should also be noted that Transpower's under-spend, every year, is despite the Commission applying various efficiency factors and downward adjustments to the threshold level proposed by Transpower."

3. The intention of the conservative or lenient approach to Transpower has been to allow the company room to move while it improves its internal budgeting, approval and implementation processes. This same approach has been used by the Commission for the last two years with only small observed improvements. If this conservative or lenient approach in favour of Transpower is worth 5%, this gives Transpower a $10.5m contingency to work with in 2009/10. This is very generous considering the return, which is the improvement in Transpower's internal processes, from the same approach in past years has been modest.

4. An alternative approach is to set a budget more akin to likely outcomes with the option for Transpower to seek review of actual costs after the event for cost-overruns. The Commission notes[3] that this is a feasible alternative but goes no further in comparing such an approach against continuing to use the status quo.

5. Something needs to be done to develop more urgency within Transpower to improve its non-Part F internal budgeting, approval and implementation processes. MEUG suggests the benefits and costs of using a tighter budget target with ex post review for cost overruns versus carrying over the lenient approach of prior years should be considered.

6. Consumers would be willing to give Transpower a greater contingency now over and above that of an efficient operator if we were assured that in the longer term relative costs would be lower than that of an efficient operator. If not, then the risk is Transpower has no more incentive than in prior years to significantly improve its performance to that of an efficient business. In that case setting a more realistic budget and placing the onus of proof on Transpower to seek approval for cost overruns might be a better strategy and should be carefully evaluated.

Yours sincerely

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[3] Paragraph 29 of the discussion paper