MAJOR ELECTRICITY USERS' GROUP

15 March 2013

Hazet Adam
Chief Adviser
Regulation Branch
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Hazet

Draft decision on the Otahuhu Substation diversity project MCA amendment

1.   This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission "Draft Decision on the Otahuhu Substation Diversity Project Major Capex Allowance Amendment" 1st March 2013[1]. The draft decision is to approve the $7.1m (in 2009 prices) cost overrun requested by Transpower.

2.   The decision by the Commission to consult on a draft decision, even though not obliged to do so[2], is appropriate given the complexity and important precedents that will be set.

3.   The summary in paragraph 3.29 of the draft decision of main themes expressed by interested persons is incomplete. For example a major theme in MEUG's submission[3] was that "the risks of cost overruns were reasonably foreseeable and were within Transpower's control". The draft decision also does not consider the downsides of approving the application that we noted [4]:

   a)   "it will reduce the incentives on Transpower to continuously improve planning and delivery of capital programmes"; and

   b)   "The propensity for politicians to influence and the Transpower Board to be influenced by political agenda will not be curtailed if this cost overrun is approved."

4.   The draft decision finds[5] "key factors were foreseeable by Transpower" and "the key factors were controllable by Transpower". On that basis alone the application does not meet the

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[1] http://www.comcom.govt.nz/otahuhu-substation-diversity-project-mca-amendment-application/
[2] Draft decision, paragraph 2.4
[3] MEUG, Otahuhu substation diversity project MCA amendment application, 9th November 2012, paragraph 4. a)
[4] Ibid, paragraph 4. c)
[5] Draft decision paragraph B10.1 and B10.2.

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MEUG to CC, Draft decision to approve Otahuhu substation cost overrun, 15-Mar-13

criteria in cl. 6.1.1(5)(a)(i) of the Transpower Capital Expenditure Input Methodology Determination [2012] (the "Capex IM") and cannot be approved. The Capex IM does not give the Commission discretion to approve an application that fails to meet criteria specified in the IM.

5.   The draft decision finds that actual costs incurred were efficient even though inadequately planned and the budgets used to seek approval were poor. In workably competitive markets an efficient project is one that is both well planned and executed. Any business where managers believed it acceptable that a project that went over budget but was implemented at best practice was an efficient outcome would not stay in business for long. Transpower may have mitigated the cost of its initial poor planning and decision to proceed at haste; but that does not overcome the fact that poor budgeting risks were foreseeable by Transpower and therefore the application fails to meet cl. 6.1.1(5)(a)(i) of the Capex IM.

6.   Having failed to adequately manage the original scoping of the work even though it was foreseeable, Transpower knowing it could not get approval for a cost overrun would have strong incentives to complete the work efficiently. In addition Transpower will have strong incentives to ensure scoping of work and budgets for future work consider all foreseeable risks.

7.   MEUG accepts the need for a mechanism for approving cost overruns that meet the criteria in the Capex IM. Things do change unexpectedly and how Transpower manages those needs to be considered. Factors that were not reasonably foreseeable but nevertheless were efficiently managed resulting in cost overruns should be accepted. The Otahuhu Substation Diversity Project fails that test.

8.   Given the[6] "one-off, transitional" nature and important precedent for future cost-overrun claims that in aggregate may be valued at many tens or even over a hundred million dollars, then an industry conference may be a prudent approach to clarify the understanding of all parties and ensure a focus on the long-term benefit of consumers and consistent with outcomes produced in competitive markets.

Yours sincerely

Ralph Matthes
Executive Director

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[6] Draft decision, paragraph X12