



MAJOR ELECTRICITY USERS' GROUP

31 January 2014

Matt Lewer
Chief adviser, Regulation
Commerce Commission

By email to regulation.branch@comcom.govt.nz

Dear Matt

Cross-submission on NIGU Project Amendment issues paper

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on submissions by other parties on the Commerce Commission issues paper "Amending Transpower's allowance and outputs for the North Island Grid Upgrade Project" (NIGUP) dated 29th November 2013. The other parties that submitted¹ were Pacific Aluminium and Transpower. MEUG also submitted.
2. Members of MEUG have been consulted in the preparation of this submission. This submission is not confidential.
3. There is nothing in the submissions of other parties to change our view of 17th January 2014 regarding areas the Commission "... may analyse further to assess whether Transpower planned and delivered the NIGU Project efficiently"². To the extent we have not changed our views the Commission can assume we disagree with many aspects of the submission by Transpower. This letter only considers two of those aspects in more detail.
4. We think Transpower's defence for not taking initiatives to review the need date or re-scoping the project including a deferral option are weak. Transpower say (page 6):

"As explained in detail in our response the Commission's question Q001, the prudent peak forecasts that we were required to use in assessing the need date for the NIGU Project did not change materially until 2011, at which point the Project was well underway and deferral was not reasonably an option."

¹ <http://www.comcom.govt.nz/regulated-industries/electricity/electricity-transmission/transpower-major-capital-proposal/amending-the-allowance-and-outputs-for-the-north-island-grid-upgrade-project/>

² Commission issues paper, 29th November 2013, paragraph 1.2

5. The first evidence continuous high peak demand growth as a basis for forecasting may be unrealistic occurred in 2008 when actual peak demand of 2,050 MW was 39 MW less than 2007 peak of 2,089 MW, ie a 2% decrease. In isolation and given the small absolute decrease this actual demand in 2008 of itself would not have been sufficient to delay the project. However the decrease followed a modest increase the prior year of 2.5%, significantly lower than the 7.3% increase in winter 2006 relative to 2005. A 2 year trend where the increase in peak demand had declined so quickly should have been recognised as an important risk factor to the true need date. In addition many parties had raised concerns on the robustness of the peak demand forecasts leading up to the Electricity Commission decisions in 2007. By winter 2008 the Global Financial Crisis (GFC) had been underway for a year³. The Reserve Bank Official Cash Rate announcement of 6th March 2008 noted⁴:

"The outlook for economic activity has deteriorated somewhat since we reviewed the OCR in January. The main reasons are weaker prospects for world growth, tighter credit conditions, a sharper-than-expected slowing in the housing market, and recent dry weather conditions. On balance, we now expect GDP growth of around 2 percent over the next three years."

6. These were all signs that pre GFC assumptions on GDP and hence electricity demand growth should be revised down. That should have been heeded by the Transpower Board. If the Board took notice of the GFC when managing its debt portfolio for example, as we would expect it would have, then it should have applied that knowledge to considering the impact on its customers and the need date for NIGUP.
7. An efficient and prudent business would have checked the possibility the need date might significantly change as early as 2008 if it truly had the interests of its customers at heart and the company might bear some risk if the project were completed before the true need date. Setting aside the latter, an efficient and prudent business would have been conscious of the net cost of sending an invoice to its customers in excess of \$100m per year for NIGUP services once commissioned, when the need date and hence benefits for that service might slip. A focus on completing the project without having a continuous and robust process for evaluating the basic reason for the project and of most importance to its customers, the need date, is not efficient, prudent or GEIP line monopoly practice.
8. Second, Transpower's submission stresses (page 8) the lawful application of the IM in relation to the option of adjusting MCA for CPI and FX. We agree and we look forward to the Commission's draft determination on this point. Transpower's view may or may not prevail but that will not curtail our concern that the balance of where the risk and rewards lie with the capex IM may, in the light of experience with this and the Otahuhu substation cost overrun applications, be unnecessarily generous to Transpower. An amendment or clarification to the IM may be needed.

Yours sincerely



Ralph Matthes
Executive Director

³ Refer Wikipedia, Financial crisis of 2007-08, http://en.wikipedia.org/wiki/Financial_crisis_of_2007%E2%80%9308

⁴ <http://www.rbnz.govt.nz/news/2008/3259437.html>