

2006 February 8

Transpower Post-Breach
Network Performance Group
Networks Branch
Commerce Commission
P.O. Box 2351
WELLINGTON

(Via email: electricity@comcom.govt.nz)

Dear Commission

I am an electrical engineer with a first class honours degree from the University of Canterbury. I have never had any association with Transpower.

I disagree with your intention to take control of Transpower, for the following reasons:

- Other options should be tried first. (I make a suggestion at the end of this letter.)
- Decision-making should reside with the body taking responsibility for the outcome of the decisions. That body is not the Commission.
- The Commission's move is hazardous for New Zealand's international reputation and does not address the issues that underlie the present problem
- The Commission have not made an adequate case that the 'pre-funding' proposed by Transpower is a bad thing
- The Commission's move reflects a dangerous attention to trivia at the expense of seeing the big picture. In the big picture, it is obvious that Transpower should be in control.

My preferred solution is for the Commerce Commission (CC) to use their good offices to broker an agreement between Transpower and the Electricity Commission (EC) whereby both organisations see themselves as *partners* in the provision of New Zealand's electricity needs. Transpower should provide the engineering judgements, the EC should provide two other things: (1) an audit function to ensure that Transpower has followed correct processes; (2) an advocate function whereby they represent the views of people affected by Transpower's proposals to Transpower. The EC should not get involved in engineering judgements. It should automatically approve Transpower's plans if correct process has been followed.

If the CC nevertheless decide to take control, it should be for a pre-announced short period (a few months), during which time they should make no determinations but seek clarification from the government as to the expected roles of Transpower and the EC.

In my opinion the Commerce Commission will not be seen to be making unbiased decisions if the EC member participates in a decision to take control of Transpower. I therefore suggest that the EC member be invited to withdraw.

I make additional comments in the attachment.

Yours faithfully

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Submission to the Commerce Commission 2006 Feb 08: Attachment

It would be dishonest to pretend that the present problem has nothing to do with Transpower's current dispute with the EC. This dispute is in the public domain and many will see the CC's proposed action as a back-door method for the EC to get their way. Since the CC is a quasi-judicial body, justice would not be served if the EC were seen to be judge and jury in their own case. It is for this reason that I believe the EC should withdraw from deliberations.

A second reason for the EC to withdraw is that as a young organisation they have not yet achieved the experience that allows us to have confidence in their judgements.

The EC have made some significant errors of judgement in recent times:

- Their decision to make the southern generators pay for aspects of the DC line was particularly unfortunate. The decision showed a lack of understanding of the national grid, equivalent in mechanical terms to thinking that a part of a flywheel can be treated as independent of the rest of the flywheel. The decision also showed the EC putting relatively trivial matters of economic purity ahead of engineering. I do not know whether the EC consulted Transpower before making this decision, but it would have been a serious error if they did not; and worse if they did but ignored the advice received.
- The EC's public suggestion of alternatives to the 400 kV project was another serious error of judgement. Their sympathising with landowners could have added several million dollars to the cost of the project. It was also wrong of the EC to suppose that their role was to choose the best option. Their proper role was to satisfy themselves that the decision made by Transpower was the product of due process and that Transpower could make a credible defence of it when confronted by angry land-owners and reluctant funders. The EC could also have played a valuable role in obtaining submissions from the public and representing those concerns to Transpower.

The EC's public flotation of alternatives to Transpower's proposal can be likened to Transfund floating alternatives to the roading proposals of Transit. At the present time Transit are finalising the route of SH20 from Hillsborough to Point Chevalier in Auckland (this route will eventually become SH1 and bypass the harbour bridge). Some landowners are discovering that their properties are directly in the path of the proposed motorway. We can imagine Transit's consternation if Transfund (in a controlling position similar to EC's control over Transpower) were to express sympathy for the landowners and tell them that the route has not been approved and might never be required. Instead, Transfund were investigating alternatives such as an elevated monorail and an underground car-train like that used in the English Chunnel!

- The EC have made a poor judgement regarding their role in relation to Transpower. They should have realised that if they (the EC) make decisions regarding the grid, then some other body is required to audit those decisions. An audit is certainly required for a

body such as the EC which has supreme powers and is in a position to abuse them. It is also needed because the sanction of last resort - public opinion - does not apply to the EC. The public do not understand 'electricity'.

Transpower is the only competent body that could conduct such an audit. Thus Transpower would be the decision-maker after all, and the EC's decisions would be merely a nuisance.

In contrast, the role that I have suggested for the EC, particularly the role of representing people's views to Transpower, would be a valuable contribution to the provision of New Zealand's electricity services.

- The EC also failed to appreciate the need to generate confidence in their decisions, rather than barge in with an exercise of power. Most of the EC's decisions so far seem calculated to generate distrust - at least for me. Their failure to appreciate the importance of the confidence factor is another error of judgement on their part.
- The EC are also making a significant error of judgement in supposing that they have the competence to make robust engineering decisions when they have only been in existence for a short time. Projects that are going to cost in the range of a billion dollars need to be given due thought, and I would suggest that 5 years is a minimum. Transpower are likely to have been considering how to upgrade Auckland's connection to the grid for 10 years or more. But the EC seem to think they can make better decisions than Transpower in a matter of months.

The EC are now in an impossible situation regarding the 400 kV project. It is obvious to onlookers that they must approve the Transpower proposal, as any decision in favour of an alternative would not be credible.

I am also concerned that the EC's decision on the 400 kV project is 'expected before July 2006', yet the EC have not made a draft decision. This manner of decision-making has long been out of fashion. The accepted practice today is 'no surprises'.

The situation is rather a mess. If the EC don't approve the proposal they will lose credibility, yet if they do approve it, they will be accused (justifiably, in my opinion) of creating unnecessary delay, causing significant extra expense, and generating a lot of ill-will. And of course, whatever decision they come to will need to be audited by Transpower.

The proper thing for the EC to have done, about a year ago, was to report that they had received the Transpower proposal and were now auditing Transpower's processes. They could have made a public statement to the effect that people should not assume there is a better option.

Then the EC could have invited submissions to see what people's concerns were, and represented those concerns to Transpower. Transpower might alter their opinion or they

might not, but the people would feel that they had an advocate, the EC, on their side. The public would be kept informed throughout, but the EC would make it clear that the decision would always remain with Transpower. Transpower is the responsible body. The purpose of public submissions would be not to choose an option, but to influence Transpower's thinking.

I do not think these 'errors' of the EC are a matter of personalities or incompetence but merely teething problems caused by the newness of the organisation and the lack of direction from Parliament. I feel that the problems can be overcome by the Commerce Commission brokering a 'partnership' agreement between the two organisations along the lines I have suggested.

Parliament must share the blame. It did not properly think through the Transpower/EC relationship before passing the legislation. My understanding is that Parliament mainly wanted to address reserve generation. Transpower governance was tacked on as something that could be conveniently addressed at the same time. The documents suggest to me that, in respect of Transpower, Parliament intended the EC to have the audit role that I have been promoting. The EC was to *ensure* process rather than *be* the process .

I see the recent court action reversing the EC's decision on the DC line as a type of 'audit action' in respect of the EC's judgements. The present action of the Commerce Commission is similar. The division of responsibilities that I am proposing in this submission would avoid this need to have auditing done by the courts.

Control should reside with the body taking responsibility

Only Transpower can take *effective* responsibility for the country's electricity infrastructure, because only that organisation is 'long-lived' and has the continuity to make present judgements and see the outcome of those judgements 30 years later. The Commerce Commission can only take short term control, and that does not allow the effects of decisions to become apparent and feed back on decision-making. I note that under 4A of the Commerce Act the Commission is required to act for the *long term* benefit of consumers.

The Commission might claim that it only wants control of money, and that Transpower can still get on with engineering. I do not accept that claim. Engineering decisions these days are mainly matters of judgement tied to money. Controlling the supply of money cannot be divorced from the making of engineering judgements.

The Commission has not made an adequate case that 'pre-funding' is a bad thing

One of the failings of governments is that often they do nothing about a problem until its effects are noticed by the public. Biosecurity is an example in New Zealand. Our government did not adequately fund this service until pests got into the country. The electricity grid is similar to biosecurity. Grid failure will be sudden and ungraceful and

we will not notice it until it hits. (The failure of down-town Auckland's distribution network a few years ago is an example.) Transpower are acting on the principle that the grid must not be allowed to fail. They are doing everything possible to ensure that it doesn't, and if the rules of economic purity (which is not the same as accounting regularity) need to be bent to achieve that objective, so be it. Many of us including the government are wishing that Biosecurity had been similarly insistent about getting the resources needed to do their job some years back.

Another example is motorway funding. The present motorways were largely built at the time of the last major grid investment. Successive governments have seen them as projects completed and have had little inclination to renew the investment. Suddenly we are faced with motorway problems; and suddenly we are faced with funding issues. In the case of the Wellington motorway, the funding problem means that works proposed by Transit for the last 20 years are unable to go ahead. A last-minute change is now being considered, representing delays, inconvenience, an inferior outcome, and a large waste of money. 'Pre-funding' might have prevented this.

All Transpower are doing, it seems to me, is attempting to take some of the funding fickleness out of the engineering equation. No matter what the reason for the grid failing - even if the reason is a bad decision by the Commerce Commission - if the grid fails, Transpower will get the blame. If a bit of 'pre-funding' can help prevent this situation, why not do it? I'm sure there are many people thinking that the best thing Transpower can do right now is get some money coming in.

If the Commission is convinced that pre-funding is as bad as they make out, they should make the case that the major grid investments of the past, and other 'Think Big' projects, were also 'bad'. Those investments didn't follow the 'just in time' rule that seems to be so important now. But the public of New Zealand are inclined to view those big investments of the past as prudent and far-sighted. They represent the sort of decision-making that should be made now.

The investments proposed by Transpower are technically sound and overdue

New Zealand society has changed a lot in the last 50 years and we should expect a similar change in the electricity infrastructure. That change has not happened, and Transpower are making a reasonable case that it should. In my opinion, Transpower's case has not been adequately refuted by the EC. It means that the CC should be cautious about siding with the EC in the present case.

Looking at 400 kV use in other countries, I find it surprising that New Zealand has not already gone this way. Other countries are surrounded by neighbouring states with self-contained systems, and can run close to the wind because they can get power from a neighbouring state in an emergency. Here in New Zealand we are entirely dependent on ourselves. If we are going to run close to the wind on energy and generation we need a better flywheel - a good grid - to compensate. But it seems that the EC want to run close

to the wind on every front. They have a 'just in time' attitude to energy conservation (the maintenance of lake levels), to the installation of generating capacity, and, it would now seem, to grid investment.

In summary, I urge the Commission to take a wider view than just whether Transpower has breached some rules. The wider view might indicate that the rules need to be changed. If so, the most productive action by the Commission would be to advise the government and not take the drastic action proposed.

I would also urge the Commission to put less emphasis on 'economic purity' and more on 'reality'. It might or might not be true that, under Transpower's plan, today's power consumers will pay more than is totally fair, but the Commission should take into account that the proposed 'pre-funding' is prudent and that Transpower are using the money for real infrastructure; they are not being fraudulent.

Finally, I ask the Commission to consider resolving the matter by brokering a 'partnership' between Transpower and the EC along the lines I have outlined. If the parties do not want to do that, the fall back should be a very short period of control by the Commerce Commission during which time nothing should happen other than the Commission seek the advice of government.

Michael Fouhy