PETITION No 56 – PILBARA UNDERGROUND POWER PROJECT

Thank you for your letter dated 30 October regarding petition #56 from Hon Robin Chapple MLC regarding the Pilbara Underground Power Project (PUPP).

The Pilbara Underground Power Project was created in 2009 as part of the Pilbara Revitalisation Plan, an initiative of the then Department of Local Government and Regional Development. The original cost estimate of $130 million was developed in conjunction with the Office of Energy and based on recent experiences with the State Undergrounding Project (including completion of the undergrounding program in Port Hedland). Further, the budget estimate was supported by the market through an open tender process.

Like many major infrastructure projects in the Pilbara over the period in question (2009-2012) the PUPP was impacted by a range of pressures associated with rapid economic expansion in the region. This resulted in high demand for resources in an environment with a finite supply of labour, materials and other support infrastructure as was seen in some of the region's major private sector projects (especially in the resources industry). Some high profile examples include Chevron’s Gorgon liquefied natural gas project, Woodside’s Pluto liquefied natural gas project, Sino Iron’s Magnetite mining project at Cape Preston and FMG’s Solomon iron ore project.

In early 2012, Horizon Power undertook a detailed review of the PUPP. This review identified a number of learnings which in turn led to the development of a revised delivery strategy for the project. Key elements included breaking the scope into smaller parcels, enhanced governance and improved cost tracking and forecasting practices (through engagement of an independent third party, Sinclair Knight Merz, now Jacobs). The revised forecast cost at completion for the project using this revised delivery model was $230 million.
Since 2012, Horizon Power has successfully completed the South Hedland and Wedgefield scope of works under the revised delivery strategy, and Karratha undergrounding works are now over 40% complete (including the suburbs of Millars Well and most of Bulgarra). To date the total project estimate remains at $230 million.

In addition to regular audits by the Office of the Auditor General, an independent audit was carried out in January 2014 by Stantons International (on behalf of the Department of Regional Development). The objective of the Stantons International audit was to review the systems and processes employed by Horizon Power in the management of the Royalties for Regions funding for the PUPP. The audit acknowledged the challenges faced by projects in the Pilbara during that time and concluded that structural changes introduced to the project met the required assurance and governance parameters for good project management and were appropriate and robust for future works.

I understand that Horizon Power, in conjunction with the City of Karratha, is responding to a number of concerns raised by members of the public, including Ms Danielle Hage from the Karratha Ratepayers Association.

For your review, I have attached a response to the six questions that the Legislative Council was formally asked to consider within petition #56.

On the basis of the efforts that Horizon Power (in conjunction with the project partners) continues to undertake in the delivery of the PUPP, along with the significant benefits to the region, local residents and ratepayers, I remain fully supportive of this project.

Yours sincerely

DR MIKE NAHAN MLA
TREASURER; MINISTER FOR ENERGY;
CITIZENSHIP AND MULTICULTURAL INTERESTS

4 DEC 2014
PETITION #56 – PILBARA UNDERGROUND POWER PROJECT

Item #1 – The failure of Horizon Power to carry out a satisfactory due diligence assessment of the project.

Horizon Power has for some time had a long term strategy regarding undergrounding power supplies in its regional service area, as it has been demonstrated to improve safety, reliability and aesthetics. Since 1990, it has been State policy that any new subdivisions be installed as undergrounded systems. Also, from as early as 2002, Horizon Power (then Western Power) had specific programs in the Pilbara that were aimed at enhancing the safety and reliability of its overhead network through an undergrounding program, such as the State Undergrounding Project in Port Hedland (2004-2006).

Based on the successful completion of the Port Hedland undergrounding scope in 2006, Horizon Power worked with an independent external consultant, Deloitte Consulting, to develop a comprehensive network hardening strategy for towns that experience adverse weather conditions. This covered towns in Horizon Power’s service area throughout regional Western Australia, from Kununurra in the north to Esperance in the south. This proposed program received broad support from Government during 2008 but did not proceed to approval stage.

In 2009 the State Government announced a Royalties for Regions funded program to modernise and transform Pilbara communities over the following four years through the Pilbara Revitalisation Plan.

The Pilbara Revitalisation Plan was approved by Cabinet and was developed to address key issues in the areas of power, water, health, and community development in the first phase and indigenous services, collaboration and partnering projects that require further development being targeted in the second phase.

The then Department of Local Government and Regional Development worked with the relevant Pilbara local governments (including Shire of Ashburton, Town of Port Hedland and Shire of Roebourne), the Pilbara Development Commission and State government agencies to identify significant regional development opportunities and develop relevant and appropriate projects for delivery as part of the Pilbara Revitalisation Plan.

The first phase of the plan supported initiatives that had already been developed within the Pilbara and aligned with the objectives of the Royalties for Regions program. Undergrounding of power in four Pilbara towns (Karratha, South Hedland, Onslow and Roebourne) was part of phase one.

The former Office of Energy had at the time undertaken a review of the State Underground Power Program which recognised the unique situation of Horizon Power networks along the Pilbara coast. Highlighted in the review was the:

- Energy security issues relating to cyclones and extreme weather events;
- Need to reinforce, upgrade or replace the ageing Horizon Power infrastructure;
- Significant isolation and exposure of Horizon Power infrastructure; and
- Higher costs associated with maintenance and fault restoration in remote networks.

The review presented a strong case for undergrounding the remainder of power connections in the coastal Pilbara region under this program.

Based on experience from the current State Underground Power Program and the actual costs in 2006/07 of undergrounding power in Port Hedland, together with input from the Office of Energy, the cost per Lot was estimated at $17,000. With approximately 5,000 lots to be undergrounded within the towns of Karratha, South Hedland, Roebourne and Onslow, the total cost of the project was estimated to be approximately $130 million over about four years. The scope also included upgrade of the distribution high voltage network in Karratha from 11kV to 22kV which was deemed necessary to meet the growing energy needs of the region.

On 29 June 2009 Cabinet approved an equity injection to Horizon Power, to be funded from the Pilbara Revitalisation Plan, to commence the progressive roll out of underground power on the basis that the State government would contribute 75% and local government would raise 25% from ratepayer contributions.

The information above describes the process used by the Department of Local Government and Regional Development and the Office of Energy (now known as the Public Utilities Office), along with Horizon Power, to confirm the scope and develop, what was considered at the time, a robust cost estimate. This work was validated when the original tenders were released in September 2009 and the open and competitive process confirmed that the market could deliver to the available budget.

Further details on the cost estimate and assurance process can be found in item #4

On 16 July 2014, the State government announced its commitment to the project through an additional $75 million in funding from Royalties for Regions for phase two of the PUPP.

Item #2 – The failure of the Shire of Roebourne to carry out a satisfactory due diligence assessment of the project that was committed to by the Shire on behalf of the community.

This is not a matter for Horizon Power.

Item #3 – The outsourcing of past and current tender agreements by Horizon Power to contractors and project managers.
Horizon Power uses a proven project management methodology which includes a mix of internal and external contract labour. As such the PUPP has always used a mix of internal and external resources.

The internal project management for the PUPP has always been made up of internal labour. This is to ensure that the interests of the business and customer are always driven from within Horizon Power.

External contract labour is then used to leverage the expertise and availability of different organisations in order to deliver various part of the project scope (including design and construction works). For the PUPP this was undertaken through an open tender process. These tenders have been open to all parties who wish to participate through the standard Horizon Power tendering system. In addition, each tender goes through rigorous probity checks by independent third parties as well as being overseen by the External Steering Committee made up of members of the Pilbara Development Commission, the City of Karratha and the Department of Regional Development and Lands.

The project continued to utilise an open tender process subsequent to the 2012 revised business case and has delivered the required works to the revised budget. Horizon Power will continue to forecast its future works using current rates as determined by the market, and reasonable escalation factors to account for future cost increases.

Item #4 – The cost overruns of the project.

The original project budget of $130 million was established in 2009 in conjunction with the Department of Local Government and Regional Development and the Public Utilities Office. The project cost developed was in line with the then recent experience from the State Undergrounding Project in Port Hedland and a reasonable escalation factor. This approach was verified by the market through an independent and open tender process.

However, like many major infrastructure projects in the Pilbara over the period in question (2009-2012), the PUPP was impacted by a range of pressures associated with rapid economic expansion as a result of a high demand for resources in an environment with a finite supply of labour, materials and other support infrastructure. This had an impact on the cost of delivering the project, as was also seen in some of the region’s major private sector projects (especially in the resources industry). Some high profile examples include:

- The cost of Chevron’s Gorgon liquefied natural gas project increasing by over $20 billion to more than $60 billion between September 2009 and November 2012. Chevron attributed the cost increase on the high Australian dollar, union demands, high-cost local manufacturing and productivity issues;
- Woodside’s $15 billion Pluto liquefied natural gas project ended up more than 25% over budget;
In July 2012, FMG announced a 19% increase in costs at its Solomon iron ore project, which in May 2011 had been expected to cost $US8.4 billion;

The cost of Sino Iron's Magnetite mining project at Cape Preston has increased four-fold to more than $US8 billion; and

The cost of Aquila Resources' West Pilbara iron ore project increased from an estimated $5.8 billion in July 2010 to an estimated $7.4 billion in October 2012, a 28% increase in 2 years.

In July 2012 Marius Kloppers, the then CEO of BHP Billiton discussed the challenges of doing business in Western Australia due to high costs. He said that the high cost of living in Western Australia was an impediment to attracting workers to growth areas. "all the other things like increased operating costs and the carbon tax have all conspired to turn us from a fairly low-cost environment and therefore competitive to a higher cost environment." Marius Kloppers July 2012.

Industry, including Horizon Power, is now more mindful of the very high rates of escalation in the Pilbara. This has eased recently, with the current PUPP cost forecast assuming escalation rates around 5.2% per annum and is supported by the conclusion of the most recent tender for works in the Karratha Light Industrial Area.

As discussed above, subsequent to O'Donnell Griffin abandoning works in 2012, Horizon Power applied a forensic approach to the forecasting the cost of project works. This has been achieved through a detailed review of the required scope and application of an appropriate strategy to deliver that scope. Cost estimates were verified by an independent third party, Sinclair Knight Merz (now Jacobs), who continue to provide ongoing cost tracking and forecasting support for the project.

Horizon Power has maintained a revised cost estimate of $230 million since 2012, noting the cost estimate includes the now completed works in South Hedland and Wedgefield. $230 million is the real price for delivering works, not a cost overrun. This has been determined through implementation of a revised delivery strategy for the PUPP, including:

- Transfer of control to the local operations team;
- Execution through smaller (more manageable) parcels of work to the market to control market variances;
- Enhanced governance through improvement to the internal and external steering committees; and
- Improved cost tracking and forecasting practices using third party reviews.

Item #5 – The failure of the Shire of Roeboume, Horizon Power and Pilbara Cities to consult meaningfully with the community as to the costs to be imposed on the community.
The PUPP was launched in 2010 in Karratha. This launch was publicised in the media and the City of Karratha followed up with a letter in 2011 to ratepayers which advised indicative costs for residential ratepayers of $3,300. Charges invoiced to residential customers issued by the City in 2014 were $3,468.

Horizon Power continued to update residents of Karratha via press and radio advertising of when and where works would commence. In addition to this, property owners who were in areas being undergrounded were communicated with directly on a regular basis to keep them up to date on works and what they needed to do to prepare. It is important to note that since the PUPP was initially launched in Karratha, there has been a high turnover of property owners in the area which may be attributable to why some residents believe they were not consulted about the project.

The City of Karratha Councillors are the elected representatives of ratepayers in Karratha and Horizon Power has kept the City fully appraised of any cost escalations. The City provided input to the Business Case which sought additional funds from Royalties for Regions and the elected representatives of the Council voted to continue with the project and provide funding.

In discussion with the City of Karratha, Horizon Power understands that the community generally supports the PUPP. This is shown by the number of ratepayers who have already made full or part payment. For example, before the due date has been reached (25 November 2014) the City has received full or part payment for over 60% of the invoices issued for PUPP. Full details can be obtained from the City of Karratha.

*Item #6 – What action should be taken by Horizon Power, the State and the Pilbara Cities Program to ameliorate the fiscal impact being applied by the City of Karratha on the recipients of the PUPP.*

PUPP was launched in 2010 in Karratha and the City of Karratha followed up with a letter in 2011 to ratepayers which advised indicative costs for residential ratepayers of approximately $3,300. Actual charges levied against residential customers were issued by the City in 2014 and amounted to $3,468. This is well under the current Perth charges for underground power.

Since project inception Horizon Power has worked closely with the funding partners to ensure the project works are delivered for a fair price. For reasons discussed in Item #4, the PUPP has been subject to a number of pressures associated with rapid economic expansion in the Pilbara region, as has also been experienced on a wide range of industrial and commercial projects in the region. However, Horizon Power has always managed its projects in order to receive fair value from its contractors. South Hedland and Wedgefield works were completed in December 2013 to the revised delivery strategy and within the revised budget. Also, even though the contract with the original works contractor in Karratha was terminated before the works were complete; the amounts paid to the contractor only relate to actual works completed (which has been independently investigated and verified).
Further, the cost of the Karratha voltage upgrade works (which includes upgrades to two substations as well as minor works within the suburbs) have been excluded from charges to the City of Karratha (and hence ratepayers). These works are funded by State Government through Royalties for Regions and by Horizon Power.

On that basis Horizon Power believes that it has acted appropriately and diligently to ensure that the project is delivered for a fair and reasonable price. Further, it has done so consistently to the revised total project cost since 2012.

The City of Karratha has also reviewed its payment options to allow ratepayers more time to pay the PUPP levies and at a lower interest rate for commercial property owners. In addition the City has reviewed and lowered charges for no-for-profit organisations. Further details regarding options provided to ratepayers can be obtained by the City of Karratha.