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Dear Alison

Transpower New Zealand Limited: compliance advice for contraventions of IPP quality standards for the 2018, 2019 and 2020 disclosure years

1. The Commerce Commission (**Commission**) has now completed its investigation into Transpower New Zealand Limited's (**Transpower**) contraventions of the quality standards for the 2018, 2019 and 2020 disclosure years under the Transpower Individual Price-Quality Path Determination 2015 (**IPP Determination**).¹
2. Having examined the information available, the Commission considers that compliance advice is the appropriate response.² We did not consider Transpower's departures from good industry practice were sufficient to require the more severe response of issuing a warning letter. However, Transpower has had successive years in which it has failed to comply with its IPP Determination. We therefore expect Transpower to learn lessons from this regulatory period and apply these to the current and future regulatory periods. Further details are set out below.

¹ https://comcom.govt.nz/_data/assets/pdf_file/0023/108239/Consolidated-Transpower-individual-price-quality-path-determination-2015-28-November-2018.pdf

² A description of the available enforcement responses, including compliance advice, can be found in our Enforcement Response Guidelines (available on our website at: https://comcom.govt.nz/_data/assets/pdf_file/0028/89821/Competition-and-Consumer-Investigation-Guidelines-July-2018.pdf).

Quality standards under the Individual Price-Quality Path Determination 2015

3. Transpower is subject to quality standards set in Part 4 of the IPP Determination for the regulatory control period from 1 April 2015 to 31 March 2020 (**RCP2**). These quality standards are the 'revenue-linked grid output measures' as outlined in the IPP Determination, which include:
 - 3.1 15 grid performance measures;
 - 3.2 two asset performance measures; and
 - 3.3 three asset health grid output measures;
 where compliance is assessed at the end of each disclosure year; and
 - 3.4 three periodic asset health grid output measures, where compliance is assessed over the five years of RCP2.
4. Compliance with the quality standards requires Transpower to meet the 'target' level for the revenue-linked grid output measures. The 'cap' and 'collar' levels for each of the revenue-linked output measures formally relate only to the calculation of the 'grid output adjustment' (ie, a revenue adjustment for performance against the quality standards).
5. In our reasons paper, we indicated that we would only pursue enforcement action where contraventions involved exceedance of the collar level of the quality measures.³ Accordingly, this letter refers to Transpower as having 'contravened' its quality standard when the collar of any quality measure has been exceeded.
6. On this basis, Transpower contravened:
 - 6.1 11 of its 20 annual quality measures for the 2018 disclosure year;
 - 6.2 7 of its 20 annual quality measures for the 2019 disclosure year;
 - 6.3 6 of its 20 annual quality measures for the 2020 disclosure year; and
 - 6.4 all 3 of its periodic (five-year) asset health grid output measures.⁴

See Attachment A for a summary of instances where Transpower's performance exceeded the collar levels for each quality measure throughout RCP2.

³ In the final reasons paper for the IPP Determination, the Commission stated that (paragraph 4.40): "*We will not take any such enforcement action for performance below the quality standard but better than the collar that is set for the grid output measure.*"

⁴ Transpower has admitted the contraventions.

The investigation

7. Our investigation into the contraventions set out above considered Transpower's publicly disclosed documents, Transpower's response to the Commission's requests for information (**RFIs**), other information provided by Transpower, Strata Energy Consulting Limited's (**Strata**) expert engineering opinion (**the Strata report**), and Transpower's compliance history with the quality standards.

Strata's expert opinion

8. The Commission engaged Strata to provide an expert opinion on Transpower's failures to comply with its quality standards in the 2018, 2019 and 2020 disclosure years. We asked Strata to provide an opinion on:
- 8.1 the causes of Transpower's failures to comply with the collar value for grid output measures in the 2018, 2019 and 2020 disclosure years; and
 - 8.2 for each cause of the failures, the extent to which Transpower had failed to comply with good industry practice for an electricity transmission operator.
9. Overall, Strata's key conclusion was that Transpower acted in accordance with good industry practice in relation to the events causing these contraventions. Strata identified a small number of departures from good industry practice in relation to Transpower's overall practices (discussed below), however these were not found to have contributed to Transpower's contraventions of the quality standards in the 2018, 2019 and 2020 disclosure years.
10. Strata largely agreed with Transpower's own analysis of the primary contributing causes for the contraventions. Strata's views are summarised below:
- 10.1 contraventions of the **grid performance measures** were primarily caused by a relatively small number of adverse weather events and one-off equipment failure events. Strata found no evidence that underlying asset deterioration contributed to the outside of collar performances;
 - 10.2 contraventions of the **asset performance measures** were largely due to planned works. In relation to one of these measures, Strata found that the collar was set inappropriately high because some significant planned works had not been identified at the time the collar was proposed;
 - 10.3 contraventions of the **annual asset health grid output measures** were largely due to:
 - 10.3.1 improvement initiatives implemented by Transpower after RCP2 quality measures were designed and agreed;
 - 10.3.2 events outside of Transpower's control, including COVID-19 lockdowns and adverse weather events; and
 - 10.3.3 improved asset management and asset condition information; and

- 10.4 contraventions of the **periodic (five-year) asset health grid output measures** were attributable to Transpower's introduction of condition-based risk management (**CBRM**) systems and the implementation of new strategies.
11. Strata also identified a number of instances where it considered that we should acknowledge improvements that Transpower has made to its systems and practices throughout RCP2, which would ultimately benefit consumers. Most significantly, Strata highlighted the immediate benefits that Transpower is realising through the adoption of CBRM systems.

The Commission's view

12. From the information gathered during the investigation, and considering the findings in the Strata report, our view is that Transpower's contraventions in the 2018, 2019 and 2020 disclosure years were not caused by failures to meet good industry practice.
13. We consider that the findings of the Strata report do not indicate any serious concerns with Transpower's wider management of the network, or of its asset management practices in general.
14. The Strata report identified the following areas where Transpower's practices did not meet good industry practice, specifically in relation to its post-event review processes. These included:
- 14.1 Transpower should ensure that its post-event reviews:
- 14.1.1 examine broader systemic and operational improvements that could reduce future risk and impacts; and
- 14.1.2 link to analysis of asset data, including performance and health.
- 14.2 Transpower should develop and document processes for its management to monitor the implementation of actions to improve interruption performance arising from post event reviews.
15. We acknowledge Strata's point that Transpower's introduction of CBRM systems and practices (currently in progress) should address the above gaps identified in relation to post-event reviews, and provide improved data and analysis tools to enable improved understanding of the underlying causes of interruptions and ways of mitigating their effects.
16. We also acknowledge Strata's view that Transpower is immediately realising benefits through the adoption of CBRM systems.

Transpower's compliance history

17. Although our investigation found that Transpower's business practices were largely in accordance with good industry practice, we note Transpower has had successive years of non-compliance and needs to bring itself into compliance.

Transpower's 2016 and 2017 quality standard contraventions

18. The Commission previously issued a warning to Transpower for failing to comply with its quality standards for the 2016 and 2017 disclosure years.⁵
19. Our decision to issue a warning was primarily based on the facts that:
- 19.1 Transpower acted largely in accordance with good industry practice, however it had contravened certain standards in part because it had failed to undertake some analysis expected of it;
 - 19.2 the design of the quality standards in RCP2 meant there was a higher likelihood of contravention; and
 - 19.3 the contraventions did not result in material detriment to consumers.

The setting of the quality standards

20. When the Commission was setting the quality measures and standards for RCP2, Transpower proposed to the Commission what it has since called 'aspirational' quality measures, comprising a much larger number of measures than applied under the first regulatory control period. The Commission adopted the proposed measures as quality standards in the IPP Determination.
21. Our investigation into Transpower's 2016 and 2017 quality standard contraventions highlighted issues relating to the setting of quality standards for RCP2, including:
- 21.1 Transpower was overly optimistic in proposing certain quality standards and did not always take into account the historic impact of planned works or events outside its control; and
 - 21.2 The fact that there were 20 different measures in the IPP Determination increased the probability of Transpower exceeding the target level of at least one of them in any disclosure period.
22. As a result, although the absolute number of quality standards contravened across all five years of RCP2 was high, we consider Transpower's behaviour to be less egregious than the number of quality standards contravened would suggest (reflecting issues with the design of the quality standards in RCP2).

⁵ <https://comcom.govt.nz/case-register/case-register-entries/transpower-new-zealand-limited3>

23. From the 2021 disclosure year, Transpower has been subject to new quality measures and standards for the third regulatory control period (**RCP3**). As part of the setting of RCP3, Transpower again proposed the quality standards that were to apply to it. We expect that the standards that Transpower proposed, and we set, for RCP3 will be achievable for Transpower, and we will consider any contraventions in this context.
24. In that regard, we are aware that Transpower has also contravened its quality standard for the 2021 disclosure year. Transpower's contravention of the quality standard for the 2021 disclosure year will be subject to a separate investigation.

Penalties for contravening the quality standards

25. Section 87 of the Commerce Act 1986 allows the court to impose a pecuniary penalty of up to \$5,000,000 where a regulated entity has contravened the quality standards set in a price-quality Path. If the court imposes a penalty, then the Commission or affected persons may apply to the Court for compensation under section 87A in respect of the loss or damage resulting from the contravention.
26. While we will not be seeking a pecuniary penalty against Transpower in respect of its 2018, 2019 and 2020 contraventions, our decision to issue compliance advice in this instance does not prevent us from seeking a pecuniary penalty in respect of any contraventions in the future. The Commission may take these contraventions into account when considering any future contraventions by Transpower.

Further information

27. This letter is public information and will be published on our website. We may make public comment about our investigations and conclusions, including issuing a media release or making comment to media.
28. Please contact Robert Cahn, Acting Head of Compliance and Investigations, on (04) 924 3776 or by email at Robert.Cahn@comcom.govt.nz if you have any questions about this matter.

Yours sincerely



Sue Begg
Deputy Chair

Attachment A: Summary of Transpower's performance against quality standards over RCP2

Grid output measure	Quality measure ⁶	Category / Circuits	Ref.	Contravention of collar ⁷				
				Previous investigation		Current investigation		
				2016	2017	2018	2019	2020
Grid performance measures	Number of unplanned interruptions	High Priority	GP1A					
		Important	GP1B					
		Standard	GP1C			X		
		Generator	GP1D		X			
		N-security	GP2E					
	Average duration of unplanned interruptions	High Priority	GP2A			X		X
		Important	GP2B		X			
		Standard	GP2C			X		
		Generator	GP2D			X		
		N-security	GP2E	X	X	X	X	
	Duration of P90 unplanned interruptions	High Priority	GP3A					
		Important	GP3B		X			
		Standard	GP3C			X	X	
		Generator	GP3D			X		
		N-security	GP3E	X	X	X	X	
Asset performance measures	HVDC availability	-	AP1					X
	HVAC availability	Selected circuits	AP2	X	X	X	X	X
Asset health grid output measures	Number of transmission towers refurbished / replaced	-	AH1				X	X
	Number of grillages commissioned	-	AH2	X	X	X	X	X
	Number of insulators commissioned	-	AH3	X	X	X	X	X
Periodic (five-year) asset health grid output measures	Number of outdoor circuit breakers commissioned	-	AH4			-		X
	Number of power transformers commissioned	-	AH5			-		X
	Number of outdoor to indoor conversions commissioned	-	AH6			-		X
Total number of contraventions		-	-	5	8	11	7	9

⁶ Refer to the IPP Determination for definitions of quality measures.

⁷ Cells with X or X indicate a contravention of the quality standard for that disclosure year.