

Approach to compliance in relation to a force majeure event

Compliance Guideline Information paper

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Contents

1	Introduction and purpose of this report	1
2	Background	1
3	Analysis framework	2
	The Authority's compliance philosophy	2
	The Authority's approach to monitoring, investigating and enforcement	2
	The Authority's approach to compliance in relation to a force majeure event	3
4	Case study – the February 2011 Canterbury earthquake	4

1 Introduction and purpose of this report

- 1.1 The Electricity Authority (Authority) is responsible for monitoring, investigating, and enforcing compliance with parts of the Electricity Industry Act 2010 (Act), regulations made under the Act, and the Electricity Industry Participation Code (Code).
- 1.2 Under Parts 3 and 4 of the Code, market operation service providers and ancillary service agents are exempt from their Code obligations and their obligations under the Electricity Industry (Enforcement) Regulations 2010 (Enforcement Regulations) in a force majeure event.
- 1.3 Other industry participants, however, do not have the benefit of the force majeure exemption in the Code. This is consistent with the position of force majeure in relation to the general law.
- 1.4 The purpose of this compliance guideline is to explain how the Authority will consider breaches of the Code, the Act, or regulations made under the Act, when these occur in circumstances where a natural disaster or other event outside of human control has occurred, and a link can be shown between the event and the breach.
- 1.5 The guideline is intended to provide industry participants with greater certainty as to how the Authority will respond, from a compliance perspective, after a force majeure event.

2 Background

- 2.1 Force majeure is a concept that arises in relation to the law of contract. It allows a party to a contract to escape liability for failing to meet its contractual obligations as a result of circumstances beyond its control. These circumstances may include both human and natural acts. Force majeure is related to the contractual doctrines of 'frustration' and 'supervening impossibility' which, if established, can lead to the termination of a contract.¹
- 2.2 Force majeure is not a concept that applies to legal obligations generally. For instance, in the event of a natural disaster or other emergency in New Zealand, the government may declare a state of emergency and invoke the Civil Defence Emergency Management Act 2002. This Act gives extraordinary powers to government officials to take steps to ensure the safety of citizens. However, the obligation of citizens to comply with the law is not suspended – even in an emergency. Some specific provisions of legislation are overridden during a state of emergency,² but in general, actions that would normally constitute a breach of the law continue to constitute a breach of the law.
- 2.3 How regulators respond to breaches of the law in times of emergency depends on what discretion the relevant legislation gives them. A flexible enforcement process, such as that within which the Authority operates, allows a regulator to consider whether it should decline to prosecute or apply a penalty, taking into account any extraordinary circumstances.

¹ In English law, “a contract may be discharged on the ground of frustration when something occurs after the formation of the contract which renders it physically or commercially impossible to fulfil the contract or transforms the obligation to perform into a radically different obligation from that undertaken at the moment of the entry into the contract.” Chitty on Contracts, 29th edition, chapter 23, paragraph 23-001.

“Historically, the concept of frustration has been invoked to mitigate the onerous doctrine of absolute contracts where performance of a contract is prevented by supervening events for which neither party to the contract is responsible and loss allocation is required.” Steptoe & Johnson LLP, The doctrine of frustration in English law, 2012, page 1.

² For example, despite the provisions of the Burial and Cremation Act 1964, government officials may undertake emergency measures to dispose of dead persons if necessary, in the interests of public health.

3 Analysis framework

The Authority's compliance philosophy

- 3.1 The Authority's compliance philosophy is to encourage continuous improvement by industry participants in the effective, efficient and reliable operation of the electricity industry for the long-term benefit of consumers.
- 3.2 In doing this the Authority will:
- (a) ensure that:
 - (i) resources are allocated where they are most needed;
 - (ii) 'minor' breaches are fast-tracked;
 - (iii) more serious breaches are formally investigated; and
 - (iv) the Rulings Panel deals with the more severe/complex cases;
 - (b) seek evidence that industry participants are 'learning' when things go wrong including ensuring that mitigating actions are taken to correct the problem and avoid recurrence;
 - (c) encourage settlement agreements between parties;
 - (d) take a pragmatic approach; and
 - (e) ensure a good compliance process is always followed.
- 3.3 The Authority's compliance philosophy guides decision making at every stage of the compliance monitoring, investigation and enforcement process. The Authority's compliance philosophy can be referred to at <http://www.ea.govt.nz/act-code-regs/compliance/>.

The Authority's approach to monitoring, investigating and enforcement

- 3.4 The Authority's policies and criteria in relation to breaches of the Act are contained in the Authority's 'Guidelines and Enforcement Criteria for Monitoring and Enforcing Compliance with the Act' (refer to <http://www.ea.govt.nz/act-code-regs/code-regs/guidelines/compliance/>).
- 3.5 The Authority's policies and criteria in relation to breaches of the Code and any regulations made under the Act are contained in the Authority's 'Operating procedures for processing alleged breaches of the Code and Regulations' (refer to <http://www.ea.govt.nz/act-code-regs/compliance/how-breach-notifications-are-processed/>).
- 3.6 The Authority's approach to monitoring, investigating and enforcing the Act, any regulations made under the Act, and the Code may be summarised as follows:
- (a) on becoming aware of an alleged breach the Authority undertakes an initial fact-finding exercise to determine whether further investigation or action is warranted;
 - (b) if an investigation into the alleged breach is warranted or required, the Authority appoints an investigator to investigate the facts surrounding the event. For alleged Code breaches the investigator must endeavour to effect a settlement between the parties affected by the alleged breach;
 - (c) once the Authority has all necessary information in relation to an alleged breach, the Authority must make a decision about:
 - (i) in relation to an alleged Code breach, any recommended settlement or recommendation to lay a complaint with the Rulings Panel; or

- (ii) in relation to an alleged breach of the Act, or an alleged breach of any regulations made under the Act, whether enforcement action is warranted and, if so, the appropriate enforcement action.
- 3.7 Consistent with clause 11 of the Enforcement Regulations, at certain points in the compliance process, the Authority may decline to take further action on a matter if certain criteria are met. These criteria are described at a high level in clause 11 of the Enforcement Regulations, and elaborated upon in the documents referred to in paragraphs 3.4 and 3.5. For ease of reference, they are listed here and are as set out in the following two paragraphs.³
- 3.8 The Authority may decline to take action on any report of an alleged breach if:
- (a) the report relates to a matter that has been, or that the Authority considers should more properly be, dealt with by any other person; or
 - (b) the Authority considers that the report fails to establish a prima facie case for the alleged breach; or
 - (c) the Authority decides that the alleged breach does not otherwise warrant further action being taken.
- 3.9 The basis for a decision by the Authority in accordance with 3.8(c) may include that:
- (a) the alleged breach:
 - (i) is minor in nature;
 - (ii) is inadvertent;
 - (iii) affects a limited number of people;
 - (iv) has caused minimal, if any, potential or actual financial, operational or security impact on the New Zealand electricity market, and has not had a direct financial impact on consumers and other parties;
 - (v) is not part of a systemic problem;
 - (vi) was not a deliberate intention to breach the provision;
 - (b) the alleged breaching party:
 - (i) rectified the breach immediately upon becoming aware of it; and/or
 - (ii) has taken steps to mitigate the breach impact and prevent recurrence, including by demonstrating that it has proper procedures in place to avoid repeating the breach.

The Authority's approach to compliance in relation to a force majeure event

- 3.10 In relation to breaches arising because of a force majeure event, the Authority will take into account the criteria set out above, and consider the timeframe within which the industry participant sought to meet its obligations following the force majeure event.
- 3.11 The Authority will overlay these decision criteria with its compliance philosophy, which as noted above, guides decision making at every stage of the compliance monitoring, investigation and enforcement process. Importantly, the Authority will adopt a pragmatic approach to its compliance decisions in relation to a force majeure event.

³ Refer to paragraph 22 of the Authority's 'Guidelines and Enforcement Criteria for Monitoring and Enforcing Compliance with the Act' and paragraph 20 of the Authority's 'Operating procedures for processing alleged breaches of the Code and Regulations'.

- 3.12 Such an event is, by definition, beyond the control of the party or parties affected by it. When, because of a force majeure event, an industry participant allegedly breaches one or more of the Code, the Act, or regulations made under the Act, the Authority will, when deciding whether the alleged breach is merely technical in the circumstances, place an emphasis on the extent to which that industry participant has sought to overcome the inability to perform its obligations and remove or mitigate the effect of the force majeure event. This is consistent with the requirement on market operation service providers and ancillary service agents under Parts 3 and 4 of the Code.

4 Case study – the February 2011 Canterbury earthquake

- 4.1 Following the Canterbury earthquake on 22 February 2011 an industry participant breached a number of provisions of the Code. These breaches related to:
- (a) updating the Registry;
 - (b) advising industry participants of changes in installation control point (ICP) information within the timeframes set out in the Code; and
 - (c) complying with the processes for annual audits.
- 4.2 These breaches caused no market impact. The industry participant quickly established communication with other industry participants affected by its non-compliance with the Code, including visiting them to explain the issues it was facing. To mitigate any operational impact arising from its inability to comply with the Code, the industry participant set up various workaround processes with these parties. The processes worked well. The Authority did not receive any breach notifications from other participants related to the non-compliance of this industry participant.
- 4.3 Following the 4 September 2010 Canterbury earthquake the industry participant had undertaken certain steps to minimise the impact of any further large earthquakes on its record-keeping requirements under the Code. This included relocating its records. Such action helped to minimise the operational impact on the industry participant when the February 2011 earthquake struck.
- 4.4 When the Authority considered this compliance case, it applied the decision criteria listed above in the context of its compliance philosophy. The Authority concluded the Code breaches were merely technical in the circumstances. The Authority noted the actions taken by the industry participant, both before and after the February 2011 earthquake, to mitigate the effects of a major earthquake on its operations and its compliance with the Code.
- 4.5 The Authority declined to take further action on the breaches of the Code, in accordance with clause 11(1)(b) and clause 11(1)(c) of the Enforcement Regulations.