

IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

**CA481/2017
[2019] NZCA 49**

BETWEEN

**VECTOR LIMITED
First Appellant**

**PAUL HUTCHISON, WILLIAM CAIRNS,
JAMES CARMICHAEL, KAREN SHERRY
AND MICHAEL BUCZKOWSKI
Second Appellants**

AND

**ELECTRICITY AUTHORITY
Respondent**

Hearing: 15 February 2019

Court: Kós P, Winkelmann and Asher JJ

Counsel: J A Farmer QC and S M Hunter for First Appellant
A R Galbraith QC and L A O’Gorman for Respondent
D A Laurenson QC and J L W Wass for Commerce Commission
as interveners

Judgment: 13 March 2019 at 3 pm

JUDGMENT (NO 2) OF THE COURT

A The appeal is allowed in part.

B Declarations are made that:

- (a) proposed clauses 12A.4(1)(b) and 12A.10(2) of the Electricity Industry Participation Code 2010 would be unlawful;**
- (b) the Electricity Authority may not regulate quality standards as that term is used in pt 4 of the Commerce Act 1986; and**

(c) **the Electricity Authority may not mandate quality standards (as above) in any distribution agreement between electricity distribution businesses and their customers or otherwise.**

C The respondent must pay the appellants one set of costs for a complex appeal on a band B basis and usual disbursements. We certify for second and third counsel at the first hearing, and second counsel at the second hearing.

REASONS OF THE COURT

(Given by Kós P)

[1] This judgment is to be read in conjunction with our judgment of 30 November.¹ That judgment allowed in part Vector’s appeal, granting a declaration that two clauses which the Electricity Authority proposed to introduce in amending the Electricity Industry Participation Code 2010 would be unlawful.² The effect of those clauses would have been to mandate the almost complete standardisation of distribution agreements between distributors (line companies, such as Vector) and electricity retailers.³ We held that the legislation did not permit the Authority to prohibit the negotiation of terms essentially collateral to standard terms mandated by the Code.

[2] That disposed of the first issue in the appeal. Our prior judgment reserved for further evidence and argument a second issue:⁴

Does s 32(2) of the Act prohibit the Authority from amending the Code to require distributors to offer a default UoSA (because such amendments prescribe quality standards for distributors, a matter reserved to the Commerce Commission)? In particular:

- (i) is the Authority prohibited from prescribing quality standards for distributors, because that is a matter for the Commerce Commission; and

¹ *Vector Limited v Electricity Authority* [2018] NZCA 543 [prior judgment].

² Vector was supported by its principal shareholders, the trustees of Entrust, who are the second appellants. We refer to them together in this judgment as “Vector”.

³ These agreements are known as “use of system agreements”, or “UoSAs”.

⁴ In this judgment “the Act” refers to the Electricity Industry Act 2010.

- (ii) in setting a comprehensive set of standardised contractual terms for distributors, is the Authority prescribing quality standards?

[3] We now have that further evidence, and those further submissions. Ultimately there was substantial consensus as to the form of declarations that should be made. The Authority eventually did not oppose the revised terms of the declarations advanced by Vector and made by this Court at the hearing.⁵ Those declarations on the second issue are rather different to those sought from Simon France J, or initially in this appeal, and reflect a measure of compromise.⁶

Issue 2: does s 32(2) of the Electricity Industry Act 2010 prohibit the Authority from amending the Code to require distributors to offer a default UoSA (because such amendments prescribe quality standards for distributors, a matter reserved to the Commerce Commission)?

[4] Section 32(2)(b) of the Act provides that the Code may not regulate anything that the Commerce Commission is authorised or required to regulate under pts 3 or 4 of the Commerce Act.⁷ Vector submits that in amending the Code to prescribe terms on which the distributors offer their services, the Authority is doing what s 32 says it may not do. They say the draft default agreement mandates quality standards for which the Commission is expressly responsible under the Commerce Act: reliability of supply, reduction in energy losses and voltage stability.

[5] We will analyse this issue after setting out the relevant statutory history and framework, the judgment appealed and the submissions made before us.

Statutory history and framework

[6] We pick up where we left off with the statutory history and framework for Issue 1.⁸ It will be recalled that the Electricity Act 1992 introduced deregulation, light-handed regulation, and the prospect of more heavy-handed regulation (including price control) if need be. Information disclosure was an important part of that regime.

⁵ The Authority did oppose a third declaration mooted by Vector, which the Court declined to make: see [33] below.

⁶ Prior judgment, above n 1, at [13]–[14].

⁷ Other than setting quality standards for Transpower and pricing methodologies for Transpower and distributors.

⁸ Prior judgment, above n 1, at [17]–[28].

The Caygill Inquiry then recommended an increased role for the Commerce Commission, setting information disclosure regulation and targeted price control for distributors.⁹

[7] A new pt 4A was added to the Commerce Act 1986 in 2001. It created a targeted control regime to promote efficient operation of markets directly related to electricity distribution and transmission services.¹⁰ A screening and post-breach enquiry process was established. The Commission was empowered to impose control on prices, revenue or quality. It is important to note that the Commission's electricity industry-focused jurisdiction pre-dated the present legislation. At the same time the Electricity Commission also held regulatory functions impacting on quality standard performance by distributors.¹¹

[8] In 2009, the earlier version of pt 4A was repealed and replaced with the present pt 4 regime. As a consequence, distributors have been subject to price-quality and information disclosure regulation by the Commission since April 2010. This was effected by the Commerce Amendment Act 2008.

[9] The Electricity Industry Act was enacted later that year. It arose from the recommendations of an electricity industry-specific ministerial review led by Dr Layton.¹² In our prior judgment we referred to a Minister's observation in the third reading debate to the intended transfer of functions from the former Electricity Commission to bodies other than the new Authority.¹³ The Minister of Energy made a similar observation in the second reading debate:¹⁴

... the bill improves the governance arrangements for the electricity industry. ... Functions that are more sensibly performed by other bodies — such as approvals for grid upgrades, management of supply emergencies, and promotion of energy efficiency — are transferred to other bodies that already have a role in doing exactly those things. We are effectively taking out duplication of effort. The objectives of the authority are narrowed to the things that it can and should be held accountable for — namely, providing for

⁹ David Caygill, Susan Wakefield and Stephen Kelly *Inquiry into the Electricity Industry* (Ministry of Economic Development, Wellington, June 2000), at [135] and ch 7.

¹⁰ Commerce Act 1986, s 57E (now repealed).

¹¹ Prior judgment, above n 1, at [20].

¹² At [21].

¹³ At [22].

¹⁴ (20 July 2010) 665 NZPD 12473.

an efficient, competitive, reliable market — and do not include things that other bodies are already legislated to do.

[10] Section 32(2) of the Act, with which we are most concerned in Issue 2, provides:

- (2) The Code may not—
 - (a) impose obligations on any person other than an industry participant or a person acting on behalf of an industry participant, or the Authority; or
 - (b) *purport to do or regulate anything that the Commerce Commission is authorised or required to do or regulate under Part 3 or 4 of the Commerce Act 1986* (other than to set quality standards for Transpower and set pricing methodologies (as defined in section 52C of that Act) for Transpower and distributors); or
 - (c) purport to regulate any matter dealt with in or under the Electricity Act 1992.

(Emphasis added)

[11] We turn now to pt 4 of the Commerce Act. Subpart 9 applies pt 4 regulation to suppliers of “electricity lines services”. These are defined in s 54C to include “the conveyance of electricity by line in New Zealand”. While they do not apply to all distribution services, they apply to the distribution of electricity to retailers. Sections 54 and 54E–54G provide that all suppliers of electricity line services are subject to information disclosure regulation. Suppliers of electricity line services that are not consumer-owned are also subject to price-quality regulation. The definition of “consumer-owned” in s 54D requires that all control and equity-return rights (for the purposes of the Electricity Act) in the supplier be held by customer or community trusts or customer co-operatives. Three-quarters of Vector’s equity is held by a community trust, so it is not consumer-owned for pt 4 purposes. Its electricity line services are therefore subject to price-quality regulation.

[12] Section 52 states that pt 4 provides for the regulation of price and quality of goods or services in markets where there is little or no competition, and little or no likelihood of a substantial increase in competition. The purpose of pt 4 is then specified in s 52A(1):

- (1) The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—
 - (a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and
 - (b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
 - (c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and
 - (d) are limited in their ability to extract excessive profits.

[13] Subpart 6 provides for “default/customised price-quality regulation”. It provides price-quality paths that control prices charged and revenue earned by a regulated supplier. Section 53K provides that the purpose of default/customised price-quality regulation is to:

... provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances.

Section 53L provides for the Commerce Commission to impose default price-quality paths for regulated suppliers for a particular period. Suppliers may also propose customised price-quality paths.¹⁵

[14] Section 53M(1), (4) and (5) provide that every price-quality path must specify:

- (a) maximum prices and/or maximum revenues that may be charged or recovered by a regulated supplier;
- (b) “the quality standards that must be met by the regulated supplier”; and
- (c) the period for which regulation is to apply (being either four or five years).

¹⁵ Commerce Act 1986, section 53L(1)(b).

[15] Section 53M(2) provides that the Commission may include incentives in a price-quality path for regulated suppliers to maintain or improve quality of supply. Those may include price or revenue penalties for failure to meet the required quality standards, or rewards for exceeding them. They may also include consumer compensation schemes (setting minimum standards of performance and prescribed amounts of compensation for failure) and reporting requirements if a supplier fails to meet quality standards.

[16] Section 53M(3) provides that quality standards may be prescribed by the Commission in any way it considers appropriate (such as targets, bands or formulae). They may include responsiveness to consumers and (in relation to electricity line services) “reliability of supply, reduction in energy losses, and voltage stability or other technical requirements”. By s 53N the Commission can require suppliers to provide information as to compliance with a price-quality path (and may require that statement be audited). Section 53O provides that a default price-quality path must include the starting prices for goods and services, the rate of price change relative to the Consumer Price Index and the quality standards that apply during the first regulatory period.

[17] Turning now to information disclosure regulation, s 53A provides that the purpose thereof is to “ensure that sufficient information is readily available to interested persons to assess whether the purpose of [pt 4] is being met”. Section 53B then provides that every supplier subject to information disclosure regulation must disclose information in accordance with the terms of a “determination” issued by the Commission under s 52P. They must supply any further statements, reports, agreements, particulars or other information required in order to monitor the supplier’s compliance with that determination. Section 53C sets out the required content of such a determination. A determination may include, but is not limited to, those matters set out in s 53C(2), which provision includes financial statements, asset values, prices and pricing methodologies, contract terms and conditions, and the like.

[18] Finally, s 54V makes provision for the interface between the two Acts. That provision was inserted by s 156 of the Act. It is part of the 2010 statutory scheme created by the Act. The Authority is required to consult with the Commission before

amending the Code in a manner that is likely to affect the Commission in its performance of its pt 4 powers. It must advise the Commission of any change increasing costs to distributors (which might therefore affect the Commission’s price-quality path calculations).¹⁶ The Commission is not required to consult the Authority. Rather, it must take into account matters within the Authority’s jurisdiction, including any provision of the Code that affects pricing methodologies applicable to distributors, and performance requirements and quality standards specified by the Authority for Transpower.¹⁷

Judgment appealed

[19] The argument made before the Judge, and before us, was that the default UoSA generally infringes the prohibition in s 32(2)(b) of the Act.¹⁸ The Judge rejected that submission. He found that the functions of the two bodies overlapped, at least potentially.¹⁹ It was clear Parliament had given the Commission a role involving the imposition of price-quality regulation: “[c]ontrolling price inevitably involves also regulating performance standards and therefore there is a potential overlap in functions.”²⁰ It was not however the intent of Parliament to cede the entire area to the Commission. Section 42(2)(f) of the Act clearly also gave the Authority “the task of standardising distribution contracts”.²¹ Moreover, the Authority also had a role in regulating service performance by retailers, unlike the Commission. This the Authority would logically do via the UoSA, as s 42(2)(f) contemplated.²²

[20] The Judge concluded that each statutory entity had a complementary role in relation to “performance services”.²³

The Authority and the Commission both accept specific clauses required by the Authority may encroach on the Commission’s function, and therefore be impermissible, but none has been identified by the plaintiff, so analysis is not needed.

¹⁶ Section 54V(3).

¹⁷ Sections 54V(4)–(6).

¹⁸ *Vector Ltd v Electricity Authority* [2017] NZHC 1774 [High Court judgment], at [82]. As the Judge noted at n 52 the appellants did not identify specific clauses they say encroach on the Commission’s domain.

¹⁹ At [84].

²⁰ At [84].

²¹ At [85].

²² At [89].

²³ At [90].

Agreed facts

[21] Ahead of the resumed hearing the parties filed a statement of agreed facts, and certain additional affidavit evidence. In light of the consensus that emerged at the hearing it is unnecessary for us to refer to the latter material in this judgment.

[22] Prior to enactment of the present Act, the Electricity Commission existed in place of the Authority. It had some limited powers to set quality standards for distributors, but never exercised them.²⁴ The Commerce Commission, on the other hand, did do so - under the previous pt 4A regime. It set price path thresholds and quality thresholds, and it had the power to impose quality standards upon a declaration of control under s 70. The latter power was never used, however.

[23] Under the present Act, the Authority again has never set quality standards for distributors. The Commerce Commission however has set quality standards for distributors in price-quality path determinations made under pt 4. These have involved an annual reliability assessment, based on system interruption indices, which measure the duration and frequency of interruptions. And, in one instance, a resilience assessment based on the earthquake resilience of a particular distributor's infrastructure. As we note subsequently, the Commission has recently indicated it may broaden its quality standard-setting remit.

Discussion

[24] In consequence of the exchange of evidence and submissions, including very helpful submissions from Mr Laurenson QC and Mr Wass, for the Commission, intervening, the disagreement between the parties narrowed considerably. As a result it is sufficient to make six points before recording the declarations the Court made at the hearing.

[25] First, the Authority (in light of our prior judgment) has undertaken further work to develop its proposed standard distribution agreement. That development, in its

²⁴ Electricity Act 1992, s 172D(10) and (11).

current form, would permit some collateral terms, the substantive content of which would not be regulated by the Code.

[26] Secondly, it is now common ground that while the Commission is required to regulate quality standards, the effect of s 32(2)(b) is not to wholly exclude the Authority from mandating some quality standards affecting distributors. It may regulate quality issues that fall outside the purposes of pt 4 of the Commerce Act. That consensus falls some way between the prior stances of the parties. Vector had earlier submitted that the Authority could not prescribe quality standards for distributors at all; the Authority had submitted that the regulatory regime was a shared one, and that it could specify quality dimensions of UoSAs to the extent the Commission was not empowered to do so.

[27] Thirdly, it follows that if there is any dispute between the parties under Issue 2, it concerns the undefined expression “quality standards” in the Commerce Act – particularly in s 53M. The remainder of this discussion addresses that question.

[28] Fourthly, the breadth of the “quality standards” the Commission may prescribe pursuant to s 53M(3) is notable: expressly without limitation, it may include responsiveness to consumers, reliability of supply, reduction in energy losses, and voltage stability “or other technical requirements”. We have noted, at [23], the limited range of what may be termed quality standards thus far prescribed by the Commission. They focus on reliability. However in a November 2018 issues paper the Commission has indicated that it is considering prescribing quality standards well beyond mere reliability. These include a number of more consumer-focused dimensions: service interruption response time, provision of information to consumers regarding power cuts and programmed shutdowns, and new connection application processing standards.

[29] Fifthly, while the functional scope of “quality standards” is cast broadly by the Act, there are two important limitations. The first is mechanistic. As Mr Laurensen put it for the Commission, it is only authorised to regulate quality by utilising the particular regulatory tools assigned to it. It does not seek to (and probably could not) directly prescribe contractual terms between distributors and retailers in the way that

(as we have held in our prior judgment) the Authority can. The second and more substantial limitation is purposive. The Commission’s power to prescribe quality standards is itself prescribed and circumscribed by defined legislative purposes. Section 52A informs that power by stating the relevant pt 4 purpose as to:

Promote the long term benefit of consumers in [monopolistic markets] by promoting outcomes ... produced in competitive markets such that suppliers ... have incentives to improve efficiency and provide services at a quality that reflects consumer demands.

Section 53K relevantly states the purpose of sub-pt 6 of pt 4 regulation to be to provide “a relatively low cost way of setting price-quality paths”, while allowing the opportunity for customised paths that better meet particular supplier circumstances.

[30] Sixthly, as Mr Laurensen acknowledged, these purposes are not coterminous with the purposes governing the Authority’s functions. By way of example, the Commission has no mandate by s 52A to promote competition in the downstream retail market. As we noted in our prior judgment, greater standardisation of distribution agreement terms may be expected to lower barriers to competition in that market and encourage new network arrangements.²⁵

[31] It follows from this discussion that two of the declarations proposed by Vector were acceptable to the Court, and were made at the hearing on 15 February 2019. They are:

- (a) The Electricity Authority may not regulate quality standards as that term is used in pt 4 of the Commerce Act;
- (b) The Electricity Authority may not mandate quality standards as that term is used in pt 4 of the Commerce Act in any distribution agreement between distributors and their customers or otherwise.

[32] Declarations in those terms were supported by the Commission, and not opposed by the Authority (although Mr Galbraith QC expressed some reservations as to their practical utility). Time will tell as to the last point, but for present purposes

²⁵ Prior judgment, above n 1, at [48].

their practical utility is to resolve the litigation between the parties in terms consistent with legal principle and enable them to move forward.

[33] A third declaration was sought by Vector, although not ultimately pressed upon us:

- (a) The Default Distribution Agreement proposed by the Electricity Authority in 2016 that was the subject of these proceedings would be unlawful if adopted by the Authority to the extent that it proposed to mandate quality standards (as above).

We declined to make that declaration for three reasons. The first was that Vector had not made a clause-by-clause attack on the draft distribution agreement before either Simon France J or this Court. The second was that the Authority proposes substantially to modify that draft agreement. And the third is that the declaration adds nothing of utility to the other declarations.

Conclusion

[34] For these reasons we made the declarations stated at [31].

Costs

[35] Bearing in mind the facts that the appellants' success is partial and that they are represented by the same solicitors, we order that the respondent pay the appellants one set of costs for a complex appeal on a band B basis and usual disbursements. We certify for second and third counsel at the first hearing, and second counsel at the second hearing.

Result

[36] We now set out the result of the appeal determined by both the prior judgment and this judgment.

[37] The appeal is allowed in part.

[38] Declarations are made that:

- (a) proposed clauses 12A.4(1)(b) and 12A.10(2) of the Electricity Industry Participation Code 2010 would be unlawful;
- (b) the Electricity Authority may not regulate quality standards as that term is used in pt 4 of the Commerce Act 1986; and
- (c) the Electricity Authority may not mandate quality standards (as above) in any distribution agreement between electricity distribution businesses and their customers or otherwise.

[39] The respondent shall pay the appellants one set of costs for a complex appeal on a band B basis and usual disbursements. We certify for second and third counsel at the first hearing, and second counsel at the second hearing.

Solicitors:
Gilbert/Walker, Auckland for Appellants
Buddle Findlay, Auckland for Respondent