

IN THE COURT OF APPEAL OF NEW ZEALAND

**CA56/2008
[2008] NZCA 289**

BETWEEN POWERCO LIMITED
 Appellant

AND COMMERCE COMMISSION
 First Respondent

AND ATTORNEY-GENERAL SUED ON
 BEHALF OF THE MINISTER OF
 ENERGY AND THE GOVERNOR-
 GENERAL IN COUNCIL
 Second Respondent

Hearing: 24 July 2008

Court: William Young P, Robertson and Ellen France JJ

Counsel: T C Weston QC, V L Heine and N S Wood for Appellant
 J S Kós QC , D J Boldt and S Davidson-Wood for First Respondent
 M S R Palmer and R Schmidt for Second Respondent

Judgment: 11 August 2008 at 4 pm

JUDGMENT OF THE COURT

- A The appeal is dismissed.**
- B Each of the respondents is entitled to costs on a 1A basis under the Court
 of Appeal (Civil) Rules (No 2) 2008, together with usual disbursements.**
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REASONS OF THE COURT

(Given by Robertson J)

Introduction

[1] Powerco Limited (“Powerco”) appeals against a decision of Wild J (HC WN CIV 2005-485-1066 24 December 2007), dismissing an application for judicial review of decisions made by the Commerce Commission (“Commission”) and by the Minister of Energy (“Minister”) under Part 4 of the Commerce Act 1986 (“the Act”) to impose control on the costs of gas distribution.

[2] This appeal essentially concerns the proper meaning and application of s 52(b)(i) and s 56(1) of the Act which provide for control (initiated by declarations of control) of goods and services which are supplied or acquired in circumstances where there is only limited competition. The crux issue is whether the Commission (and, relying on the Commission’s advice, the Minister) were correct, as a matter of law, to value wealth transfers as part of the cost-benefit analysis mandated by those sections. “Wealth transfer”, in this context, denotes the consequences of the reduction in the price paid by acquirers of gas services as a result of the removal of Powerco’s monopoly rents.

[3] The parties agree that declarations of control are aimed not at the promotion of competition, which is not possible in monopolistic (or monopsonistic) markets, but at mimicking the economic externalities of effective competition for the benefit of either acquirers (s 52(b)(i)) or suppliers (s 52(b)(ii)) of goods or services. Where the parties diverge, however, is on the view that ought to be taken of wealth transfers and the implications of that view for the appropriate cost-benefit analysis.

[4] Section 52 of the Act provides:

52 When control may be imposed

Goods or services may be controlled if –

- (a) the goods or services are, or will be, supplied or acquired in a market in which competition is limited or is likely to be lessened; and
- (b) it is necessary or desirable for those goods or services to be controlled either

- (i) in the interests of persons acquiring the goods or services (whether directly or indirectly), if the goods or services are acquired from a person who faces limited or lessened competition for the supply of those goods or services; or
- (ii) in the interests of suppliers, if the goods or services are supplied to a person who faces limited or lessened competition for the acquisition of those goods or services.

[5] Section 56 of the Act provides:

56 Reports from Commission to Minister about controls

- (1) The Commission may report to the Minister on whether or not an Order in Council under section 53 should be made, amended or revoked.
- (2) The Commission may have regard, in considering a report, to all matters it considers necessary or desirable.
- (3) The Commission may report at any time on its own initiative or following a request from the Minister.
- (4) If the Minister requests a report, –
 - (a) the request must be in writing; and
 - (b) the request must specify the date by which the Commission must report; and
 - (c) the Commission must report accordingly.

The Minister must publish the Commission's report in a manner that he or she considers appropriate.

...

[6] Of importance also is s 1A, which was introduced by the Commerce Amendment Act 2001. That section provides:

1A Purpose

The purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand.

The factual situation

[7] Powerco and another enterprise, Vector, are in the gas pipeline distribution market, which has a strong natural monopolistic character. Powerco is New Zealand's second-largest natural gas distribution company, both by customer connections and by network length, representing 46% of New Zealand's gas connections and serving the central and lower North Island regions.

[8] Part 4 of the Act provides for the imposition of control by Order in Council on goods or services that are supplied or acquired in a market in which there is little or non-existent competition.

[9] In April 2003, the Minister requested that the Commission investigate New Zealand's gas transmission and distribution markets. This covered eight companies who operate in the field. In July 2003 the Commission released a draft framework paper setting out the background to its proposed inquiry. Powerco made submissions on this framework paper.

[10] The Commission undertook an examination of all of the companies, in light of the criteria in s 52 of the Act. The Commission sought to ascertain the actual and projected returns of each of the eight companies between 1997 and 2008 and to evaluate how these returns exceeded what might have been expected in a market subject to competition.

[11] The exercise involved an estimation of the returns that an efficiently operating company trading in a competitive market would expect, as against the actual returns. The difference was described as "excess returns". This was discounted by 20 percent (deemed to be "unrecoverable") and allowance was made for the costs of control and any gains or losses in efficiency (productive, allocative and dynamic) that might flow from control.

[12] The Commission concluded that all the companies were making excess returns, but eventually it recommended that action should be taken only in respect of Powerco and Vector, for which the excess returns were the highest.

[13] In May 2004 the Commission issued its draft report, and its final report was issued in June 2004. In November 2004, the Commission reported to the Minister under s 56 of the Act. In July 2005 the Minister, under s 53 of the Act, recommended to the Governor-General that an Order in Council imposing control be made. This occurred.

The litigation

[14] Before Wild J, Powerco and Vector challenged much of the Commission's methodology and calculations. However, the appeal in this Court, by Powerco alone is in respect only of Wild J's treatment of the Commission's interpretation and application of s 52 of the Act, and the associated actions of the Minister in recommending control to the Governor-General.

This appeal

[15] There were five points identified in the appeal, but there is a substantial degree of overlap. They are:

- (a) Was Powerco's position mischaracterised by the Commission and/or Wild J?
- (b) Were the Commission and the Minister incorrect, as a matter of law, to value wealth transfers when applying the statutory test?
- (c) Must the Net Public Benefit ("NPB") test be positive before control may be declared?
- (d) Was the Commission's use of a "transfer cost ratio" ("TCR") substantially and procedurally unsound?; and
- (e) Did the Commission fail to give adequate reasons for its decision?

[16] All counsel before us were agreed that the starting point for this appeal is the words of s 52(b)(i) and their meaning within the Act as a whole. However, before we discuss the parties' submissions on the correct interpretation of the relevant statutory provisions, we consider Powerco's first appeal point that its position has been mischaracterised by the Commission and/or Wild J.

Has Powerco's position been mischaracterised by either the Commission or Wild J?

[17] Powerco submits that both the Commission and Wild J misunderstood its position on the appropriateness of the NPB and "Net Acquirer Benefit" ("NAB") tests.

[18] In his judgment, Wild J stated the Commission's submission on the meaning of s 52 of the Act to be that:

[118] Powerco is wrong to submit that s 52 focuses on the new Zealand economy as a whole, or on all consumers in New Zealand. Such an interpretation is inconsistent with the clear wording of s 52, which focuses on the interests of direct or indirect acquirers. That means what it says. It does not mean "all consumers", who will not be acquirers of a particular good or service in a particular market in which competition is limited.

Later, Wild J concluded that:

[153] I regard the Commission's interpretation of s 52 as a legitimate one, if not a much more compelling one than that advocated by Powerco. At the very least, I hold that the Commission's interpretation of s 52 is one reasonably open on the language of the section. On its wording, s 52 focuses on the interests of acquirers (direct and indirect) and not on all consumers, who will not all be acquirers of Powerco and Vector's gas distribution services, in the particular markets in which they operate.

[19] These paragraphs illustrate the understanding of both the Commission and Wild J that Powerco advocated a cost-benefit analysis that subjects the interests of acquirers to the interests of the economy ("New Zealand consumers") as a whole.

[20] Powerco submits that this understanding is mistaken. It says it does not contend that the interpretation of s 52 is resolved by selecting a winning trump in a "simple contest" between NPB and NAB. In other words, Powerco says that it is not fixated on NPB. Rather, Powerco argues that, although the s 52 test must be

conducted with reference to the interests of acquirers, those interests should include only the “net efficiencies” relating to acquirers, and should not include wealth transfers.

[21] We find no substance in this point. It is an attempt by Powerco to cast its argument for the primacy of NPB in terms of acquirers so as to give the argument traction within an expressly acquirer-centric test. It amounts to the proposition that what is good for the economy as a whole is good for any sub-set of it, and therefore good for a particular sub-set, in this case acquirers. That method of argument subsumes all particularised interests within the global interest of NPB, and is implausible in light of the expressly stated acquirer-based test of s 52. The Act’s particular contemplation of the interests of acquirers in s 52(b)(i) would be vacuous if those interests amounted to no more than the interests of all (and any) other discrete subset(s) of the economy.

[22] Whether the Commission or Wild J characterised Powerco’s argument as a contest between NPB and NAB, rather than as an NPB test with respect to acquirers, is substantially immaterial.

Wealth transfers under the Act

[23] Mr Kós QC and Mr Palmer submitted that the statutory interpretation question before the Court was straight-forward. The Act requires that control be imposed where it is necessary or desirable in the interests of acquirers, and this enquiry does not hinge on a NPB test. It hinges on an NAB test, which does not subject the particular interests of acquirers to the broader interests of the economy as a whole.

[24] Mr Weston QC submits that the respondents’ argument is simplistic. Of course a wealth transfer is in the interests of acquirers, but where the Commission, the Minister and Wild J went wrong, Mr Weston submits, was in reading s 52(b)(i) in a vacuum, detached from its legislative pedigree. Section 52 of the Act, he argues, must be read within the broader philosophical context of the Act as a whole, which is concerned “to promote competition and markets for the long term benefit

of consumers within New Zealand” (s 1A). He submitted there is a clear body of jurisprudence affirming his proposition that in Commerce Act matters, wealth transfers are to be treated neutrally. The only wealth with which the Act is concerned is net economic wealth, and regulation that results in a net economic inefficiency is impermissible under the Act.

[25] The general regulatory approach to monopolies under the Act was articulated by the Privy Council in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 at 407-408 when it said:

Monopolies act to the detriment of the consumer by permitting the monopolist to charge higher prices than would be the case if there were a fully competitive market. This problem can be tackled in one or other or both of two ways viz by a regulatory body artificially restricting the price chargeable or by introducing efficient competition. ... The Commerce Act, inter alia, directed itself to both these processes: s 36 is designed to produce the competition which will, it is hoped, in due course compete out monopoly rents: Part IV of the Act enables immediate price restriction to be imposed by regulation.

[26] We agree with Mr Weston that, in interpreting the words in a statute, they must be read in context and that their interpretation should not create absurdities.

[27] We also accept Mr Weston’s submission that, after much litigation over the scope and application of Part 2 (restrictive trade practices), Part 3 (business acquisitions) and the implementation provisions in Part 5, there is an accepted approach to regulation under the Act which in the main excludes valuation of wealth transfers. Counsel for Powerco noted particularly; *Air New Zealand v Commerce Commission (No 6)* (2004) 11 TCLR 347 (HC); and Australian authority emphasising the primacy of dynamic efficiency: *Re Dr Ken Michael AM, ex parte Epic Energy* [2002] WASCA 231; *Re Qantas Airways Ltd* (2005) ATPR 42-065 (Australian Competition Tribunal); and Report 17 of the Australian Productivity Commission (September 2001). The Australian decisions are of limited application in New Zealand, given our different approach to regulation.

[28] Mr Weston’s interpretation, however, does not sit easily with the statutory framework at issue in this appeal. We do not consider that the interpretation

contended by Mr Weston for s 52(b)(i) is necessary to avoid an interpretative absurdity, and nor do we consider that it is the correct interpretation of the section.

[29] We cannot accept that s 52 envisages only an NPB test, even if that test is couched in terms of acquirers. NPBs, by their nature, do not discriminate between discrete groups in the economy. They are truly utilitarian, with each economic actor counting for no more or less than any other. But s 52 expressly provides for acquirers. That express provision would be superfluous, and distinctly out of place, if the s 52(b) test involved consideration of only NPBs. The reference to acquirers must have a practical effect on the consideration to be undertaken.

[30] The fact that other parts of the Act may properly exclude the valuation of wealth transfers does not determine the correct interpretation of Part 4. We are satisfied that to adopt the appellant's approach would so shrink the application of Part 4 as to render control virtually a practical, if not theoretical, impossibility.

[31] Part 4 provides a statutory remedy for markets in which there is inadequate competition and where the mechanisms in Part 2 (which apply to markets in which there are multiple participants, and which prohibit trade practices that substantially lessen competition) cannot apply.

[32] Section 52(b)(i) requires the Commission and/or the Minister to evaluate the costs and benefits of control with reference to acquirers. It would seem to subvert the purpose of this cost-benefit exercise not to consider the value of the monopoly (or monopolistic) company's excess returns and the extent to which their transfer would be in the interests of acquirers.

Must NPB be positive before control may be declared?

[33] As a consequence of its argument that the Act is ultimately concerned only with NPB and costs, Powerco submits that control under Part 4 of the Act may be declared only where doing so would result in an NPB. This argument is contingent upon according primacy to s 1A of the Act.

[34] As a matter of statutory interpretation, this submission is problematic. As the Commission has noted, it was open to the legislature to provide expressly for an NPB requirement in s 52. There is no express requirement. Other sections, in other parts of the Act, provide expressly for a threshold NPB before the Commission may make authorisations (see for example ss 61(6) and 67(3)(b)).

[35] In the absence of express provision for NPB in s 52, and in light of the view we have taken of Powerco's submission that "the interests of acquirers" are to be construed with reference to net economic efficiencies only, we reject a reading of s 52 which includes a requirement that NPB be positive before control may be declared. We do not consider that "the interests of acquirers" can properly be construed without reference to wealth transfers, which are an obvious and significant benefit to acquirers. We do not consider that NPB must be positive before control may be declared.

[36] There is no statutory prohibition upon declaring control where to do so would result in a net economic cost. The purview of s 52 of the Act does not extend to the economy as a whole. It focuses on one discrete part of the economy, namely acquirers. The Minister is able to declare control if he determines simply that to do so is necessary or desirable in the interests of acquirers. It is a conceptual and linguistic stretch to exclude a substantial wealth transfer from the cache of benefits that would accrue to acquirers from control.

The TCR

[37] Mr Weston argued that the investigative approach adopted by the Commission in this case was unprecedented because of what was described as the TCR. The TCR represents the proportionate costs and benefits of imposing control: the net economic cost of imposing control is divided by the quantum of wealth that would be transferred from Powerco to acquirers if control were declared. Powerco takes issue with this formula, submitting that to compare net economic losses with benefits accruing to acquirers is to compare "apples with oranges".

[38] We accept the Commission's submission, and affirm Wild J's conclusion that the TCR is nothing more than an accessible formula for demonstrating the costs of imposing control with the benefits. It is not a problem that the costs and benefits do not pertain to exactly the same economic sphere, since s 52(b)(i) mandates consideration of acquirers' interests. Indeed, it is reassuring that the Commission and the Minister were cognisant of the broader economic impacts of imposing control and assessed those impacts against the interests of acquirers.

[39] The TCR was not a revolutionary or aberrant mathematical device, and its use by the Commission was neither disingenuous nor conceptually unsound.

Did the Commission fail to give adequate reasons for its decision?

[40] Powerco submits that the Commission should have given full and reasoned justification as to why it valued wealth transfers, and that it failed to do so.

[41] In the High Court, Wild J accepted that the Commission was required to give reasons adequate to enable its decision to be understood.

[42] Before us, the Commission's response to Powerco's claim that the Commission did not give adequate reasons is two-fold:

- (a) The Commission's posture towards wealth transfers was made plain in the Draft Report, at the conference on the Draft Report and in the Final Report; and
- (b) Powerco objects to wealth transfers being valued in the s 52(b) test. The Commission's entire assessment methodology hinges on valuing wealth transfers. Therefore, the reasons and justifications for the Commission's inclusion of wealth transfers in its calculations are in fact globally integrated into its reports.

[43] We accept the Commission's submissions on this point. To a large extent, Powerco begs the question, in submitting that the Commission was obliged to give

reasons, by assuming that valuing wealth transfers is presumptively unreasonable and therefore requires explanation.

[44] If the Commission is correct (as we consider it to be) that wealth transfers are properly part of the s 52(b) analysis, then wealth transfers were valued in its analysis because s 52(b), in its terms, required that to happen.

[45] We are satisfied that the Commission was transparent and consistent in its evaluative methodology, and its reasoning was sound.

Must the Minister satisfy an additional “should” threshold before imposing control?

[46] Under s 53(4), the Minister may make a recommendation for control on his own initiative, or after seeking advice from the Commission, as he did here. Powerco submits that because the Minister sought, and relied upon, the Commission’s advice before recommending control, the decision of the Minister stands or falls with the decision of the Commission. That is, if the Commission’s recommendation of control is found to be erroneous in law, then the Minister’s recommendation too must be incorrect. We find no error in the Commission’s interpretation and application of the s 52(b) test, and therefore Powerco’s submission on this point cannot affect the outcome of the appeal.

The nature of the exercise

[47] It is not surprising that there is an absence of germane overseas jurisprudence. In most comparable jurisdictions, the issue for the regulator is not whether there should be regulation of monopolistic utilities companies, but only how regulation should be implemented. New Zealand, with its emphasis on light-handed intervention, starts the enquiry at the “should” stage, which involves an enquiry by bodies like the Commission in evaluations that, in other countries, are determined by the legislature.

[48] The New Zealand approach is to start with a presumption of non-regulation. This can be displaced if the appropriate criteria in the Act are met. The burden to displace the presumption against non-regulation falls to the Commission and the Minister. In the usual course, the Commission is consulted for its expertise and that expertise is accorded a suitable degree of deference by the Courts. McGrath J in *Unison Networks Ltd v Commerce Commission* [2008] 1 NZLR 42 (SC) noted that:

[54] Often ... a public body, with expertise in the subject-matter, is given a broadly expressed power that is designed to achieve economic objectives which are themselves expansively expressed. In such instances Parliament generally contemplates that wide policy considerations will be taken into account in the exercise of the expert body's powers. The courts in those circumstances are unlikely to intervene unless the body exercising the power has acted in bad faith, has materially misapplied the law, or has exercised the power in a way which cannot rationally be regarded as coming within the statutory purpose.

[49] It is clear from his judgment that Wild J preferred, by a substantial margin, the interpretation of s 52 advanced by the Commission to that advanced by Powerco. We find no basis upon which to depart from Wild J's assessment of the process followed, and decision reached, by the Commission and the Minister.

[50] At [153] of his judgment, Wild J said that the Commission's interpretation of s 52 was at least "reasonably open on the language of the section". We agree. Indeed we consider it to be the correct approach. The interpretation advanced by Powerco is based on an interpretation of Part 4 of the Act which is unsustainable. We reject Powerco's fundamental proposition that wealth transfers are wholly excluded from the Act's contemplation.

Result

[51] It therefore follows that we are satisfied that Wild J was correct in dismissing the application for judicial review and the appeal is dismissed. Each of the respondents is entitled to costs on a 1A basis, together with usual disbursements.

Solicitors:
Chapman Tripp, Wellington, for Appellant