

POWERCO LIMITED

INFORMATION DISCLOSURE: THE STATUTORY FRAMEWORK

- 1 These submissions were originally intended to address Powerco's written submissions responding to the Commission's proposals about ACAM (as to whether Powerco's line businesses are to be treated as a standalone business). However, as further consideration was given to the issue, it became apparent that a wider context was required. That wider context arises from the Commission's frequent reliance (in the Discussion Paper) upon price reductions/wealth transfers as informing its proposals. The issue of price reduction/wealth transfers cannot be examined without reference to NAB/NPB assessments and their relevance (or otherwise). These submissions approach this topic through the lens of statutory interpretation.
- 2 Consequently, we propose making some submissions today about that wider context, primarily to set the scene for the narrower issue of ACAM. We are alert to the Commission's prioritisation for this conference (paragraph 441) but, at the same time, concluded that we needed to say something about NAB/NPB.
- 3 Further work will be required (on the part of Powerco) on the topic of NAB/NPB. We anticipate that the Commission will want to engage on that topic in more detail in due course. The following submissions, to the extent they deal with this wider topic, are thus preliminary and subject to further refinement. As will be obvious, these submissions will have ramifications beyond the information disclosure issues now being considered by the Commission. That is why we think something needs to be said about them now. The Commission has explicitly stated that it intends using the information obtained under subpart 3 as an input for its activities in relation to subpart 1. In paragraphs 51 and 121 of the Discussion Paper the Commission expressly notes that, in designing and implementing the proposed changes to the information disclosure regime, it has had regard to what it calls the implicit

complementarity of subparts 1 and 3 of Part 4A. It is trite, of course, that two subparts of a wider part of an Act may well be complementary. Powerco's submission, though, is that the Commission's assessment of that complementarity needs to be handled with care. As will become apparent from the following submissions it appears that the Commission's thinking is based substantially on assumptions about the importance of wealth transfers and this thinking, in turn, is based upon its reading of the relevant purpose statements.

4 These are old topics for Powerco and the Commission and, in one sense, nothing that we say below is new. In recent months, though, the Commission has articulated its view of Parts 4 and 4A and this has provided a framework in which the relevant entities can respond. Powerco, as a participant in both the gas inquiry and the electricity inquiry believes it is well placed to deal with these issues.

5 Powerco relies upon two recent Commission documents for its understanding of the Commission's thinking on the topic of assessing net benefits. The documents are:

- The Assessment and Inquiry Guidelines (19 October 2004). See executive summary at pages 9 and 10; main text at paragraphs 88-91 and 99.
- The final report of the Commission in the Gas Inquiry (19 November 2004). See paragraphs 4.13, 4.32-4.37, 4.49, 4.50, 6.1, 6.5, 14.71 and 14.73.

6 At the outset, Powerco accepts that the Commission is part of the audience intended to benefit from information disclosure (it is one of the "*wide range of people*" referred to in section 57T(1)). Therefore, information disclosed under subpart 3 may well be used by the Commission in discharging its functions under subpart 1. In that sense, and as already noted, the two subparts can be said to be complementary. One of the issues, today, is the nature of the relationship between the two subparts. Is – or should – subpart 3 be the

primary source of information in relation to subpart 1? What is the role of sections 70E and 98?

- 7 Powerco submits that information disclosure has a role irrespective of subpart 1. That, too, is the view of the Commission. Equally, the two subparts both fall within Part 4A and such legislative structuring suggests a degree of complementarity. But, having acknowledged that, it is not entirely helpful to suggest that information relevant to subpart 1 "*is only a subset*" of the total disclosure regime (Discussion Paper, paragraph 51). This suggests a mechanistic relationship between the two subparts. Rather, subpart 3, and particularly section 57T, needs to be separately analysed. Subpart 3 is concerned with disclosure and comparison. It is not obviously concerned with reconciliation of the disclosures nor, necessarily, all aspects of subpart 1. The Commission itself recognises that some information relevant to subpart 1 will be received other than through subpart 3 but that the majority of information will come through information disclosure under subpart 3. The Commission relies upon commonsense and transparency considerations to support its conclusions (eg, Discussion Paper, paragraphs 94, 109 and 110). The statutory basis for such a conclusion is not clearly stated.
- 8 The Commission's Discussion Paper in relation to information disclosure analyses the scheme of the Act and discusses the relevance of the purpose statements in Part 4A (sections 57E and 57T). Powerco has previously made submissions about the role of these purpose statements and the Commission now acknowledges that the thresholds, for example, are not intended to achieve, in equal measure, each of the three components of section 57E (Threshold Decisions, 1 April 2004, paragraph 100).
- 9 Powerco believes that acknowledgement to be an important one, and an improvement over the Commission's original position. Nevertheless, Powerco continues to submit that the purpose statements are aids to interpretation rather than formal checklists (for example, relying upon section 5, Interpretation Act 1999). Section 57M provides an obvious exception, but an exception that tends to prove the rule. Throughout the Discussion Paper, the Commission

speaks of meeting the provisions of either section 57E or 57T as if they were a checklist (eg, Discussion Paper, paragraphs 51, 122, 123, 158, 222, 227, 320). While the Unison judicial review has yet to be heard and determined, it appears that the Commission's lawyers in that case may hold a different view as to the role of these purpose provisions. We set out Unison's pleading in paragraph 5 of its statement of claim and the Commission's response:

- *"The powers conferred on the Commission under subpart 1 must be exercised for the purpose set out in section 57E."*
- *"Admits that the purpose of Subpart 1 is set out in s 57E and that Subpart 1 confers powers on the Commission but says that the relationship between those powers and s 57E in each case can only be determined as a matter of interpretation in particular of the scheme of the Subpart and the entire Act. Except as admitted it denies paragraph 5."*

10 Powerco has reservations, too, about the Commission's technique of identifying what it calls "*a common overall purpose*" by laying sections 57E and 57T over each other (Discussion Paper, paragraphs 31 and 51). It is, of course, proper to note the overlap between the two purpose statements, but the fact of the matter is that each of the two purpose statements continues in differing terms, and each must be analysed on the basis of the words used in the provision. It is not orthodox statutory interpretation to give greater weight to the common portion of the two purpose statements than to the other words used in those purpose statements.

11 The purpose provisions do need to be properly interpreted by the Commission. Powerco submits that, because the Commission continues to use these purpose provisions as check lists, too much weight is being given to ensuring that there are price reductions and that wealth transfers are made to customers. Powerco's submission is that the NAB, as an overall net benefits assessment, is not actually mandated by the Commerce Act and that the Act's concern with long-term consumer welfare (NPB) should also be the fundamental concern of Parts 4 and 4A. These submissions inevitably focus attention upon the

reference to acquirers ("persons acquiring... (whether directly or indirectly)...") in section 52(b)(1) and to passing on price reductions in section 57E(c) ("share the benefits of efficiency gains with consumers, including through lower prices"). It appears to Powerco that the Commission relies upon these provisions, in particular, to conclude that NAB assessment is appropriate in relation to these parts of the Act and thus to focus upon wealth transfers.

- 12 The NAB assessment, of course, can be contrasted with the NPB assessment used in the case of authorisations (for example, section 67(3), Commerce Act). NPB assessment predates the introduction of section 1A (setting out the overall purpose of the Act) and, indeed, section 3A (Commission to consider efficiency). Yet, as the High Court has recently recognised in *Air New Zealand/Qantas* (Judgment dated 17 September 2004), at paragraphs 238 and 241, the authorisations process treats wealth transfers as neutral and the introduction of section 1A was not intended to alter that.
- 13 At this point, the Productivity Commission's report dated 28 September 2001 can also be noted. See pages 134 and 135 (attached). The Productivity Commission concluded that transfers should not be the concern of competition law. It can be noted that in recent times the Minister of Commerce (speech dated 21 February 2005) endorsed a more recent report from the Productivity Commission and spoke of the desirability of a common approach in Australia and New Zealand in relation to the business environment.
- 14 Neither of the High Court in *Air New Zealand/Qantas*, nor the Productivity Commission, provides final answers in relation to Parts 4 and 4A. However, each does serve to contrast with the approach taken by the Commission.
- 15 In a practical sense the difference between the NAB and NPB assessments is found in the treatment of wealth transfers (Gas Inquiry, paragraph 4.50). The NPB assessment is based upon efficiencies (productive, allocative and dynamic). The NAB assessment includes, in addition, the discounted value of transfers to consumers that may result from price reductions. As the Gas Inquiry illustrates, the inclusion of the value of these transfers can be

significant because the NAB assessment may be positive whereas the NPB assessment may be negative (see tables 20.1 and 20.2).

- 16 In the appendix to these submissions Powerco explores the background to the amendments to the Act in 2001 to investigate whether there was an express legislative intention to introduce the NAB assessment in Parts 4 and 4A. The conclusion of that analysis is that there was no such intention. And, indeed, that is consistent with the purpose statements of sections 57E and 57T to promote the efficient operation of relevant markets. In the case of section 57E the purpose statement goes on to emphasise that it is "*for the long-term benefit of consumers*", exactly the same wording as used in section 1A. It is inconceivable that the legislature would have intended different conclusions in relation to the two uses of an identical phrase. It does not appear that the Commission has made a connection between sections 1A and 57E. Rather, the Commission appears to have treated (wrongly) "*consumers*" as being synonymous with "*customers*".
- 17 To conclude at this point, then, Powerco understands the Commission will have regard to price reductions (and see paragraph 27 below) but submits that for both of Parts 4 and 4A the ultimate net benefits assessment is NPB rather than NAB. The following discussion about ACAM must also be addressed in the context of wealth transfers. Powerco looks at this in two ways. First, it notes the relevant efficiency issues. Secondly it addresses statutory interpretation.
- 18 First, Powerco addresses ACAM in the context of efficiency. If ACAM is to be abandoned (or amended so significantly that it is effectively abandoned) then the efficiency consequences of that will need to be addressed at the point the changes, and the use to which the amended ACAM is to be put, are established. Powerco made substantially the same point in paragraph 4.38 of its submissions made in June 2004 in relation to the Commission's draft Gas Inquiry report.
- 19 The Commission is obviously alive to the question of wealth transfers that may result from changes to ACAM. These are referred to in paragraph 227

where the Commission acknowledges that there is value in ensuring that firms have incentives to achieve gains and to keep the benefits for themselves. While others from Powerco will speak to this, the question of wealth transfers is a significant one for Powerco both as to the existing state of affairs and the likelihood that such changes would stifle future merger activity. The Commission will need to address whether these consequences, primarily to dynamic efficiency, would lead to the promotion of the efficient operation of the relevant markets. Powerco suggests not.

20 Secondly, the relevant issues of statutory interpretation are now addressed. Powerco acknowledges the Commission's concerns about ACAM. These are primarily set out in paragraphs 222 and 225 of the Discussion Paper. But the Commission does not clearly state what it proposes to do about those concerns other than to suggest, in paragraphs 226 and 229, that a greater level of prescription may be required. In paragraph 228 the Commission concludes that disclosure across multi-utilities should not account for more than the total of common costs. The Commission explicitly states that these issues may justify the disclosure of other information (226). Presumably that is intended to link back to the conclusions in paragraphs 115 and 116 (and see also paragraphs 76-79). Therefore, at least in part, it appears that the Commission's proposed changes to ACAM underpin its proposal to seek information in relation to Powerco's contestable businesses.

21 In order to justify seeking the further information, the Commission has emphasised the terminology in subpart 3 whereby "*large line owners*" are required to make the disclosure (paragraphs 76-79, 114-116). The Commission contrasts this with the language used in subpart 1 which refers to "*large electricity lines businesses*". This contrast can indeed be made but the use of terminology in the two subparts is not entirely consistent:

- (a) The purpose as set out in section 57T(1) is to promote the efficient operation of markets "*directly related to electricity distribution...*". While the subsection then goes on to refer to owners that is in the limited context that the provision is concerned with markets directly

related to electricity distribution. Subsequent references in the same subsection to “*those businesses*” can only be references to the businesses of electricity distribution (cf Discussion Paper, paragraph 77).

- (b) The Commission does not refer to “*suppliers*” as used in section 57E. While this is not a defined term its inclusion rather suggests the Commission is placing too much weight upon the terminological differences between subparts 1 and 3. The concept of a “*supplier*”, focusing on the entity supplying, is closer to that of a “*lines owner*” than an “*electricity lines business*”.

22 In any event, the terminological differences can also be explained on the basis that the legal entity conducting the lines business is the one that makes the disclosure about the lines business (subpart 3) but that it is the particular lines business which is regulated (subpart 1).

23 Powerco has already made written submissions suggesting that too much weight has been placed upon the terminological differences. It has objected to the Commission’s proposal to obtain wider information disclosure, submitting that section 57F(2)(a) requires disclosure of information about the standalone lines businesses and no other. This is orthodox regulatory practice and, moreover, the practice was specifically endorsed by the High Court in *Welgas Holdings Limited v Commerce Commission* [1990] 1 NZLR 484.

24 *Welgas* was an appeal by Welgas against a determination of the Commission allowing NGC a price increase. A number of arguments were ventilated, one of which is directly relevant to these submissions. At pages 499 and 500 the Court addressed an argument by the appellants (Welgas and others) that NGC should pull down some of its parent company’s tax loss allowances so that its own tax position would have a reduced impact. The Court rejected this argument, concluding it would violate the standalone concept of price regulation which required regulation of the price controlled operations of NGC only (relevant portions attached).

- 25 In its written submissions Powerco has noted that paragraph 114 of the Discussion Paper misstates section 57T(2)(a) (*“the business of being a large line owner”* rather than *“their business as a line owner”*). The thinking revealed by that misstatement, however, appears to underpin the Commission’s proposals to seek disclosure of information about contestable businesses within the Powerco enterprise.
- 26 Fundamentally, the Commission’s proposals to change ACAM seem to be driven by its desire to ensure that efficiency gains are shared with customers (with resulting wealth transfers). For example, in paragraph 227 (and see also 222) it says *“The provisions of Part 4A also require efficiency gains to be shared with customers over time”* (emphasis added). Presumably, this is intended to be a reference to section 57E. If so, this is not accurate for at least two reasons. First, and as already noted, it overstates the role of the purpose provision (which it wrongly paraphrases in any event). Secondly, section 57E(c), which is in subpart 1, contains a reference to sharing benefits with consumers, including through lower prices. Even then, it is subject to the purpose statement of promoting the efficient operation of the relevant markets for the long-term benefit of consumers, and to the overall purpose statement contained in section 1A. But, in any event, subpart 3, which is concerned with the disclosure of defined information, does not have any provisions that provide for efficiency gains to be shared with consumers. Therefore, the conclusion then drawn by the Commission, *“allowing less than the full stand-alone costs to be allocated to the monopoly business over time is one way whereby sharing of efficiency benefits with consumers might be encouraged”*, is to conflate subpart 3 with subpart 1.
- 27 The point can be further illustrated. The thresholds address section 57E(c) by use of the C factor. The Commission has been able to achieve its goals in subpart 1 notwithstanding disclosure on the basis of ACAM as part of the existing information disclosure regime. By collapsing subpart 3 into subpart 1 the Commission now appears to find a justification for its proposed changes to

ACAM. On what Powerco submits is the proper interpretation of the Act, subpart 3 does not mandate nor authorise the proposed changes.

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APPENDIX

1 In order to place this argument in context it is necessary to focus on three particular aspects of the 2001 amendments to the Act.

- The introduction of a new purpose statement as section 1A.
- The introduction, in section 52(b)(i), of the words “*the interests of persons acquiring the goods or services (whether directly or indirectly)*” which has led the Commission to develop the NAB.
- The introduction of Part 4A.

Legislative history of first amendments in 2001

2 Put briefly, the process followed by the legislature was this:

- In 1999 there were two separate Bills being the Commerce Amendment Bill (introducing the new purpose statement and enhanced penalties etc) and a second Bill described as the Commerce (Controlled Goods or Services) Bill.
- On 7 February 2001 the Commerce Amendment Bill was reported back from the Commerce Select Committee.
- Within about six weeks, on 26 March 2001, the Commerce Amendment Bill (No 2) became available which collapsed the two 1999 Bills (together with at least one SOP) into the new Bill.
- The new Bill had its first reading on 4 April 2001.
- On 20 April 2001 the Ministry provided the Commerce Select Committee with a report explaining the key thinking behind the new Bill.
- The Bill was read for the second time on 9 May 2001 and was considered part by part by the Committee of the Whole House on 10 and 15 May 2001.
- The Bill received its third reading on 23 May 2001 and Royal Assent on 25 May 2001.

Enhanced purpose statement: section 1A

3 It is submitted there is little doubt that the new purpose statement was intended to make it clear that the Act was designed to enhance the welfare of New Zealanders. On this approach, transfers would be treated as neutral.

4 For example, in a Cabinet paper prepared in March 2000 the Acting Minister of Commerce (Hon Trevor Mallard), at paragraph 14, said:

“However, competition is merely the means used to promote an innovative, dynamic and robust domestic economy to the ultimate benefit of all New Zealanders. Thus I propose that a purpose statement be added to the Act to make it clear that the ultimate objective of the Act is to promote the welfare of all New Zealanders.”

- 5 When the Commerce Committee reported back the Commerce Amendment Bill on 7 February 2001 it said much the same thing at pages 5-7. For example:

“...Competition is not an end in itself but a means to increasing consumer welfare in the long term. The ultimate goal is to facilitate effective competition to promote economic growth...”

- 6 Then, at page 7, the Committee said:

“We consider that the addition of the purpose statement will not fundamentally change the interpretation of the Act. It is clear that the statement will confirm the existing approach that competition is a means to an end, not an end in itself. The difference is that it does this more explicitly than the existing long title, and clarifies that it is the impact on the long-term welfare of consumers within New Zealand that should be the overarching goal when assessing market behaviour. ...

We, however, consider that the proposed purpose statement should be simplified to emphasise and reinforce the primary purpose of the Act in promoting competition for the long-term benefit of consumers within New Zealand. This can be accomplished by excluding reference to the efficient operation of markets. We also considered whether the words “long-term” may lead the courts and the Commission to over emphasise dynamic efficiency at the expense of more immediate benefits. We accept the words “long-term” on the basis that welfare is defined as the welfare of consumers within New Zealand. The authorisation process should continue to be seen largely as an efficiency exception. We recommend the addition of an amended version of the statement in the SOP.” (emphasis added)

- 7 In the explanatory note to the Commerce Amendment Bill (No 2) it was said:

“The purpose statement clarifies that competition is not an end in itself, but a means to promote the long-term benefit of consumers and New Zealanders as a whole.”

- 8 Similarly, the Hon Paul Swain said at the second reading:

“We are inserting a new purpose statement in the Commerce Act to clarify that the courts and the Commerce Commission should focus on promoting competition in markets for the long-term benefit of the consumers within New Zealand Competition, where appropriate, can encourage greater productivity, innovation, and lower prices in domestic markets. Consumers can benefit directly.

...

Of course, competition in markets is the goal, but there has to be an end point gain, and that is for the long term benefit of consumers."

- 9 David Cunliffe said during the second reading with regard to the change to the purpose clause:

"We are saying what really counts is what we do for our people, the consumers of New Zealand, not for our businesses. Secondly, we talk about the long-run benefit."

- 10 When debating Part 1 of the Bill, the Hon Paul Swain said that:

"it was self-evident that, ultimately, the beneficiaries should be the consumers, who could be anyone – producers, domestic consumers, etc.,. One of the things we were trying to do in this legislation was bring ourselves more into line with Australian legislation."

- 11 Why is this history relevant? Both sections 1A and 57E speak of *"the long-term benefit of consumers"*. If section 1A is an overall consumer welfare statement then one can properly expect section 57E to be the same. That is, both mandate an NPB approach. However, the Commission has clearly interpreted section 57E as requiring an NAB approach (for example, see pages 9 and 10 of its Assessment and Inquiry Guidelines dated 19 October 2004). Powerco submits that in doing so the Commission has erred.

Interests of acquirers

- 12 Prior to the amendments in 2001 section 53(2) set out the threshold for a control recommendation. It roughly corresponded with the threshold now set out in section 52. The second part of the test (necessary or desirable) spoke in terms of *"in the interests of users, or consumers, or, as the case may be, of suppliers"*. This has now been changed to referring to *"... the interests of persons acquiring the goods or services (whether directly or indirectly)..."*. The Commission appears to have relied upon this wording for the NAB. Is that justified? Powerco submits not. There does not appear to have been any legislative intent to effect such a change.

- 13 In the explanatory note to the Commerce Amendment Bill (No 2) the new control provisions in Part 4 were explained thus:

"Those provisions are largely the same as those currently contained in the principal Act, but they have been rewritten so they are not limited to the control of prices."

- 14 In then explaining the new sections 70-74 the explanatory note said these had been updated to give the Commission increased flexibility in administering control. There was a reference to formulae such as CPI -X. The explanatory note then concluded:

“The provisions are more broadly drafted to avoid the possibility of the specific overriding the general. No diminution in the range of options available to the Commission is intended.”

- 15 In the first reading speech for the Commerce Amendment Bill (No 2) the Minister of Commerce (Hon Paul Swain) said:

“We are not proposing to introduce price control. Rather, we are giving the Commerce Commission more tools in the toolbox.”

- 16 The most important paper in relation to the control amendments is that prepared by the Ministry dated 20 April 2001. In paragraph 23 the paper summarises the substantive changes proposed over the existing Act. There are six of these listed, none of which suggests that the NAB is being introduced to replace the NPB.

- 17 Then, in paragraphs 28, 29 and 30, the important conclusion:

“28 However, in the process of redrafting the SOP, the Ministry also sought to include some technical changes which have not been considered by Select Committee. In short:

a all of the changes are technical and do not amount to a change in policy;

b the changes would improve the legislation; and

c no significant problems would arise if some or all of the changes were to be rejected by the Commerce Select Committee.

29 The changes are discussed below.

- Replacing the ‘interests of consumers and users’ with the ‘interests of persons acquiring the goods or services, whether directly or indirectly’*

30 In the threshold for when control may be imposed (section 52) and the considerations to be observed by the Commission (section 70A), the reference to “interests of users or consumers” has been replaced with “interests of persons acquiring the goods or services (whether directly or indirectly)”. The Commerce Commission raised this point. The original language was too inflexible if the market failure was at the wholesale level. The amendment removes any doubt that the Commission may consider the interests of end consumers. However, it is unlikely that the Commission or courts would get it wrong if the former language were to be used. (emphasis added)

- *Clarifying that the thresholds for imposing controls are designed to assist the Minister in assessing whether price control should be imposed.”*

- 18 It was further noted by David Cunliffe during the second reading that the Bill did not separately and of itself go out for public consultation, and that therefore the Commerce Committee was careful to ensure that there was no new material of a controversial or policy nature.
- 19 This analysis shows that the introduction of the concept of an acquirer was intended to have no policy significance. Certainly, it is no foundation on which to base the introduction of the NAB test (which first saw the light of day in the Airport inquiry). Rather, the correct test should have been overall consumer welfare – the NPB test. Ultimately, this is what the Minister relied on in refusing to order control.
- 20 It is interesting to note, as Powerco’s submission to the Minister of Energy noted (in relation to the Gas Inquiry), that following the Airports inquiry, the Ministry initiated a review of the distortions caused by the NAB and its apparent inconsistency with NPB. It is entirely understandable that the Ministry should have been concerned. The easy answer, however, is that the NAB has been introduced in error. The real and subsisting assessment is NPB. Consequently, there are no actual distortions to be assessed.

Part 4A introduced

- 21 Part 4A (comprising ss 57D to 57ZK) was inserted, as from 8 August 2001, by section 3 of the Commerce Amendment Act (No 2) 2001.
- 22 The Commerce Amendment Act (No 2) 2001 started life as the Electricity Industry Bill and was introduced on 28 November 2000. The purpose section was then 57B and read:
- “The purpose of this subpart is to promote the efficient operation of the markets **for** electricity distribution and transmission services through **price** control for the long-term benefit of consumers by ensuring that suppliers-
- (a) are limited in their ability to extract excessive profits; and
 - (b) face strong incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
 - (c) share the benefits of efficiency gains with consumers, **-in the electricity distribution and transmission markets.”**
- 23 This purpose section differs to what we now know as section 57E in three respects, highlighted in bold. First, “for electricity distribution and transmission services” was changed to “directly related to electricity distribution and transmission services”. Second, “price control” was changed to “targeted control”, and third, the words “in the electricity distribution and transmission markets” were removed from sub-paragraph (c) and replaced with “including through lower prices”.

- 24 The Bill was read for the first time on 13 December 2000 and referred to the Commerce Committee, however the committee was unable to reach agreement on a report and Opposition members voted against the Bill being reported back to the House. The Bill was discharged from the Committee on 28 May 2001 and proceeded to its second reading on 28 June 2001. Supplementary Order Paper 156 was then tabled, including the amendments proposed by the Committee. Clause 17 of SOP 156 inserted section 57E.
- 25 After the Bill had been debated by the Committee of the whole House on 25 July 2001, it was divided into 4 separate Bills pursuant to SOP 159.
- 26 During the debate, Doug Kidd criticised section 57E for stating the purpose was to be promoted through “targeted control”, which was not defined and departed from the original provision which said “price control”. David Cunliffe responded that the select committee had considered whether control should be targeted or universal, and that the Opposition members of the committee had favoured universal control.
- 27 Owen Jennings queried what “share the benefits of efficiency gains with consumers” meant. There was no clear answer.
- 28 The Commerce Amendment Bill (No 2) was read for the third time on 31 July 2001 and was assented to on 7 August 2001. The third reading did not address Part 4A or its purpose specifically.

That said, the Commission has changed the wording of its draft sub-clause (b) to make it clear that the role of Part IIIA is to act as a discipline on, rather to prescribe the composition of, industry-specific regimes.

RECOMMENDATION 6.1

The following objects clause should be incorporated in Part IIIA of the Trade Practices Act 1974:

‘The object of this Part is to:

(a) promote economically efficient use of, and investment in, essential infrastructure services; and

(b) provide a framework and guiding principles to discourage unwarranted divergence in industry-specific access regimes.’

What about distribution?

The ACCC questioned the focus of the objects clause because it considered that the concept of ‘economic efficiency’ does not have regard to distributional issues:

While the concept of ‘economic efficiency’ entails a measure of social desirability, it focuses on the productive, allocative and dynamic dimensions of a market, without regard to any distributional issues. (sub. DR93, p. 5)

While this is true, in general, curbing monopoly power for efficiency reasons will reduce transfers from final users of infrastructure services to facility owners. Thus, there will often be a congruence between the pursuit of efficiency and distributional outcomes that many would regard as desirable.

Nonetheless, because consumers of infrastructure services are a diverse group covering a wide range of income levels this may not always be so. This illustrates the problems of trying to target distribution through such regulation. As the NECG noted, distributional objectives are more appropriately addressed using instruments which can be better targeted to achieve the desired outcomes:

Commonly, monopoly pricing is attacked because it involves a transfer of wealth from consumers to the monopoly producer. However, the most serious problem caused by monopoly pricing is the loss of social welfare, which results from the monopolist’s profit maximising restriction of output ...

This is not to suggest that distributional issues are unimportant — they are important, and need to be addressed. However, concerns about income distribution are best dealt with through explicit distributional policies that rely on the instruments available through the tax and welfare systems. (sub. 39, p. 20)

Other participants concurred that the national access regime is not appropriate for addressing distributional concerns. The Queensland Mining Council submitted that:

We do not believe it would be appropriate to include distributional issues in [Part IIIA] ... in our view that is a matter for governments to determine outside the operation of access regimes. (sub. 27, p. 6)

In a similar vein, the NCC stated that:

The national framework for competition policy ought not to be concerned with the distribution of income – distributional goals are best pursued by other, more direct, means. (sub. 43, p. 28)

And, responding to the Position Paper, EnergyAustralia (sub. DR106) expressed the same view.

Indeed, explicit pursuit of broader distributional goals through an access regime could be inconsistent with the efficiency objective of Part IIIA. For instance, if a regulator attempted on distributional grounds to set low access prices to assist particular groups of consumers, it could have adverse (short and long term) effects on efficiency. Yet, by using a more targeted instrument, such as budget-funded community service obligations, selected groups of consumers could be assisted without those deleterious impacts.

At a recent conference on Regulation and Investment (convened by the ACCC), it was noted that overseas experience had also shown the drawbacks of pursuing distributional goals through access (and related) regulation. For example, the former Chief Economist of OFTEL (the telecommunications regulator in the United Kingdom) noted that well-meaning regulation designed to accelerate artificially the spread of new services more broadly than otherwise would occur — for example, to ‘thin’ regional markets — could actually deter or delay investment in such services.

For all of these reasons, the Commission considers that it is not appropriate to provide the regulator with the discretion to use Part IIIA to pursue distributional outcomes.

FINDING 6.1

The national access regime is not an appropriate vehicle for pursuing distributional outcomes.

Elaboration of the objects clause

An objects clause is a first stage espousal of the purpose of legislation. As a general statement of principle, an objects clause, of itself, does not provide regulators with

Welgas Holdings Ltd v Commerce Commission 5

High Court (Administrative Division) Wellington 10
 19, 20, 21, 22 June; 13 July 1989
 Jeffries J and W J Shaw

Administrative law—Tribunals and Boards—Commerce Commission—Natural justice—Wholesaler applied to Commerce Commission to increase price of natural gas to retailers—Commission refused to give copy of application to retailers—Commission prepared draft decision, gave copy to wholesaler for comment, and as a result of submissions received its altered decision in favour of wholesaler—Whether Commission had acted in breach of natural justice to retailers—Whether relief should be granted to retailers if decision was correct—Commerce Act 1986, s 70. 15 20

Commercial law—Commerce Act—Price control—Formula for controlled wholesale price of natural gas—Commerce Commission issued decision increasing price of natural gas supplied by wholesaler to retailers—Whether Commission was correct in including as a price factor the wholesaler's "take or pay" liability to the Crown as gas producer—Whether tax imputation required wholesaler's tax liability to be ignored—Whether wholesaler's parent company's tax losses should be taken into account—Whether decision of Commission was correct—Commerce Act 1986, s 70. 25 30

Where competition in the supply of goods or services is limited, the Commerce Commission may be authorised (by Order in Council made under s 53 of the Commerce Act 1986) to control the price of supply. The wholesale price of natural gas was controlled accordingly. Natural Gas Corporation of New Zealand (NGC), a wholesaler, applied to the Commission (under s 70 of the Commerce Act) for authority to increase the price of natural gas supplied to Welgas Holdings Ltd (Welgas) and other retailers. An increase was authorised, and Welgas and others appealed against the price determination made by the Commission. There were three matters for decision by the High Court on appeal: (a) whether there had been a breach of natural justice or fairness in the procedure followed by the Commission; (b) whether the Commission, in fixing the increased price, was justified in taking into account NGC's liability to the Crown under an agreement whereby it undertook to pay for gas whether it was supplied or not; and (c) whether certain taxation factors affecting NGC and the company of which it was a subsidiary (Petrocorp) should likewise be taken into account. As to the issue of breach of natural justice or fairness, the Commission refused to give the appellants a copy of NGC's application (though it provided what was said to be a summary); it gave NGC, but not the appellants, a draft of proposed determination; and having heard submissions on the draft from NGC, but not from the appellants, it materially altered the draft (to the disadvantage of the appellants) before making a determination. The reasons for this course of conduct were not disclosed to the Court, and no claim was made that it was justified by the demands of commercial confidentiality (which in any case was of limited scope in the circumstances of this case). As to the issue of NGC's liability to the Crown, in 1977 NGC made an agreement with the Crown, the producer of natural gas, to pay for an annually 35 40 45 50

increasing amount of gas from the Maui field (the amount being based on expected demand), whether it took that minimum amount or not. Demand had not increased at the rate then expected; other fields had come on stream; and the contingent liability for gas not taken had become actual and substantial. Who should ultimately bear the cost of this arrangement (producer, wholesaler, retailers, consumers) raised questions of much difficulty. The Commission had made an earlier decision on the wholesale price and in doing so had left open the possibility of annual reviews. In the determination under appeal the Commission decided that it was fair that all those involved in or having the benefit of the supply of gas should bear part of the cost of supply, and that in calculating the price on the present application NGC's liability under the "take or pay" agreement for the previous year, and half its liability for the current year, should be brought into account, capitalised, and written off over 15 years. On the final issue there were two taxation matters to consider. The first was whether NGC's tax liability should enter into the calculation at all. The Commission had used an abstruse formula in calculating what was a reasonable wholesale price for gas, the wholesaler (NGC) being a company. It involved the use of a factor equal to the rate of tax paid by the company. The appellants contended that this factor should be excluded from the calculation, following the introduction of imputation, which enables a shareholder to be credited with the tax paid by the company in respect of the dividend on his shares, thus avoiding double taxation of his income derived from the company (once by way of tax on the company's profit, and a second time on the dividend in the shareholder's hands, paid out of that tax-paid profit). The second matter was an alternative contention. The appellants argued that if the tax factor was not excluded altogether, some effect should be given to the fact that NGC was a wholly-owned subsidiary of Petrocorp, Petrocorp had "tax losses" to offset against profits, and under the income tax regime NGC could use some of those losses to reduce its own tax liability.

Held: 1 The Commission is required by statute to have regard to the submissions of the applicant when fixing prices, and is empowered to consult any person likely to be helpful. There is no express requirement to observe the principles of natural justice (as there was under the Commerce Act 1975, since replaced). But participants other than NGC had a legitimate expectation that they would be treated equally with the applicant in the matter of the supply of the vital information constituted by the draft determination. Those concerned should have been given that information. So to hold did not involve grafting on to the statute provisions about natural justice or fairness not contemplated by the legislature. In the event, the final decision of the Commission was correct, so no relief would be granted to the appellants on this head, other than the finding that the Commission had erred (see p 490 line 24, p 496 line 14).

Air New Zealand Ltd v Overseas Investment Commission [1986] 2 NZLR 470 distinguished.

2 The Commission's decision to take account of NGC's "take or pay" liabilities, and the extent to which they were given effect in the determination of price, had been effected after consideration of the relevant arguments. The determination represented a balancing of conflicting interests and an allowance for very uncertain future factors. It was reasonable in the circumstances and would not be upset (see p 495 line 31).

3 The true effect of imputation on the accepted formula for calculation of the wholesale price was not capable of resolution in a mathematical or absolute sense, as was evident from the sharply opposed testimony of the expert witnesses. Under the imputation system companies still paid tax, and it could not yet be said that from an investor's point of view debt and equity yields were equal. Including

a tax factor in the formula took account of these factors. Further, the Commission was an investigatory tribunal which had been assisted by a narrowly expert body which had recommended the inclusion of a tax factor, and therefore this was an area where particular weight should be given to the Commission's decision to include the tax factor in the formula. Accordingly, the Commission's decision was correct (see p 498 line 7, p 499 line 19). 5

4 The price-controlled operations of NGC should be considered alone. Petrocorp's tax position was irrelevant to this "stand alone" principle, and no allowance should be made for the possible use by NGC of Petrocorp's tax losses (see p 500 line 1). Appeal dismissed. 10

Other cases mentioned in judgment

Auckland Bulk Gas Users Group v Commerce Commission [1990] 1 NZLR 448.
Bradley v Attorney-General [1988] 2 NZLR 454. 15

Council of Civil Service Unions v Minister for the Civil Service [1985] AC 374; [1984] 3 All ER 935 (HL). 15

Customs (Comptroller of) v Gordon & Gotch (NZ) Ltd [1987] 2 NZLR 80.

Fletcher Metals Ltd v Commerce Commission (1986) 6 NZAR 33.

Jim Harris Ltd v Minister of Energy [1980] 2 NZLR 294.

Pearlberg v Varty (Inspector of Taxes) [1972] 1 WLR 534; [1972] 2 All ER 6 (HL). 20

Shotover Gorge Jet Boats Ltd v Jamieson [1987] 1 NZLR 437 (CA).

Smitty's Industries Ltd v Attorney-General [1980] 1 NZLR 355.

Appeal

This was an appeal under s 91 of the Commerce Act 1986 against a determination of the Commerce Commission. 25

D J S Laing and G N Gallaway for the appellants (Welgas Holdings Ltd and others).

Susan Bathgate for the first respondent (the Commerce Commission). 30

I R Millard and S Hewson for the second respondent (Natural Gas Corporation of New Zealand Ltd).

Cur adv vult

JEFFRIES J and W J SHAW. The wholesale and retail aspects of the natural gas industry have been under price control for many years with decisions invested in the Commerce Commission since the Commerce Act 1986, which is now the controlling statute. The government in 1987 signalled deregulation of the retail sector, but the foregoing represents the current position. There have been three decisions of the Commission on applications by the Natural Gas Corporation of New Zealand Ltd (NGC) which is the wholesaler and a retailer in the North Island. The decision before the one under consideration went on appeal to the Administrative Division of the High Court, *Auckland Bulk Gas Users Group v Commerce Commission* [1990] 1 NZLR 448. It is an important decision concerned primarily with the adoption by the Commission of a new formula for the price increase application of NGC for the year ending 30 September 1988. That was decision No 207 and was the second decision of the Commission under the Commerce Act 1986 (hereafter referred to as "the Act") with the first being decision No 174 dated 11 September 1986. In decision No 207 the Commission adopted an accounting rate of return/capital assets pricing model (CAPM) to calculate the cost of capital to NGC. It is a relatively new formula which has found favour in other countries and was the recommendation to the Commission from a Working Party comprising members from the Commission and Petrocorp. The use of that formula was challenged in *Auckland Bulk Gas Users Group v Commerce Commission* but it was unsuccessful. 35 40 45 50

We allow Dr Hudson to summarise his position by reproducing para 53 of his third affidavit:

5 “Put simply, dividend imputation means that companies can provide shareholders with their required after-tax return on investment from a smaller pre-company tax income than was required under the previous tax regime. Companies no longer have to generate the extra income they previously needed to fund a second change.”

10 The opposing experts, again we hope we are not distorting their view, start from the premise that it is the company itself which is the issue not the investor. The company must pay its tax and, therefore, “t” is properly placed and used in the equation in an application for a price increase to a regulatory body. Imputation simply is an advantage to the shareholder who gets tax free dividends. Mr Smith seems to concede that in extreme or classical cases (as advanced by Dr Hudson)

15 imputation could have some bearing. However, the reality of the market over the last 30 years has been that few shareholders have paid double tax because companies have devised strategies (mainly by use of capital) to ensure the equity investor is not penalised.

20 We have reached the conclusion that the formula using the “t” factor is correct for the following reasons. As stated we think this is a particular area where weight should be given to the Commission’s decision to include it. After careful examination of the opposing deponents’ evidence we prefer the view taken by Dr Evans and Mr Smith. Both deponents express no doubt it is properly used, and Mr Smith’s New Zealand experience with CAPM in several industries in this country

25 must carry weight. Furthermore, Dr Evans, who is based in Toronto, and familiar with the North American scene, and cognate schemes whereby investor taxpayers may receive dividends tax free, stated that this has not resulted in any regulatory tribunal reducing the income tax allowance for the utility. We find it difficult to overcome the basic point that under imputation companies still pay tax, even though

30 theoretically they may require lesser income for the equity yield. We do not believe it can yet be said, even from an investor’s viewpoint, debt and equity yields are equal. In the WACC formula NGC seeks to have that recognised in its cost of equity capital.

35 Perhaps in July 1989 it is not inappropriate to mention the story of the Chinese historian who was asked to give his view on the consequences of the French Revolution. He replied that he could not possibly comment on such a recent event. We feel somewhat the same about the possible influence of imputation on equity investment. We think it prudent to await the reaction of companies, investors (internal, overseas, institutions, debt and equity, etc), the equity market and others

40 to the imputation system because it may not behave precisely as intended. Until the full implications are known we think NGC is entitled to the use of “t” in the WACC.

We disallow this ground of appeal.

45 *Petrocorp’s tax losses*

 We turn to the appellants’ alternative argument on tax which was as follows. NGC is a wholly owned subsidiary of Petrocorp and its subsidiaries are entitled to carry forward tax losses incurred before 31 March 1988, and that is not in dispute. Petrocorp has available tax losses arising in part from gas exploration and development including the Maui fields. On the basis it was submitted that

50 to the extent that Petrocorp’s losses relate to gas exploration and development relevant to the price controlled market for gas the losses should be taken into account when determining the taxation component in NGC’s tariff structure. In other words NGC should pull down some of Petrocorp’s tax loss allowance so that their own tax position causes a reduced impact. This is very much an alternative argument of the appellants for their primary submission is that all tax considerations should be excluded.

The short answer and the one we think disposes of the argument is that it violates the "stand alone" concept in price regulation. We do see the argument of the appellants that there is some connection between some of Petrocorp's tax loss credits and NGC's theoretical tax position, but that is not decisive. In so far as it is possible, and we recognise anomalies can creep in, we think that logic and commercial sense calls for the retention of the "stand alone" principle. We think Dr Evans' affidavit at paras 47-52 is persuasive, and particularly para 49 which we reproduce: 5

"In respect of NGC, the stand-alone concept implies that: (1) the risks being evaluated for the rate of return purposes should be those of the *price-controlled operations only*; (2) the assets in the asset base should be those of the *price-controlled operations only*; (3) the depreciation expense should be that associated with the assets in the asset base, which are those for *price-controlled operations only*; and (4) the income tax expense to be recovered in the rates is calculated on the after-tax equity return, which is the product of a rate of return that reflects *price-controlled operations only* and an asset base which reflects *price-controlled operations only*." (His emphasis.) 10 15

This ground also fails.

The appellants have been largely unsuccessful by this appeal, but on one main ground succeeded. We note that in the *Auckland Bulk Gas Users Group* costs were reserved and we do likewise leaving it to counsel to file memoranda if necessary. 20

Appeal allowed. 25

Solicitors for the appellants: *Brandon Brookfield* (Wellington).
Solicitors for the first respondent: *Crown Law Office* (Wellington).
Solicitors for the second respondent: *Kensington Swan* (Wellington).

Reported by: J N Matson, Barrister 30