IN THE SUPREME COURT OF NEW ZEALAND

SC 12/2007
[2007] NZSC 74

	BETWEEN	UNISON NETWORKS LIMITED Appellant
	AND	COMMERCE COMMISSION Respondent

Hearing: 19 and 20 June 2007

Court: Blanchard, Tipping, McGrath, Anderson and Gault JJ

Counsel: D J Goddard QC and L Theron for Appellant
R A Dobson QC and J S McHerron for Respondent
A R Galbraith QC, M Chen and N J Russell for Vector Limited
(Intervenor in relation to relief)

Judgment: 10 September 2007

JUDGMENT OF THE COURT

A The appeal is dismissed.

B Unison is ordered to pay the Commission costs of $25,000 plus reasonable disbursements to be fixed if necessary by the Registrar.

C Costs in the Court of Appeal and High Court are to be determined by those Courts in light of this judgment.

REASONS

(Given by McGrath J)

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Introduction

[1] In 2001 Parliament enacted a new scheme for regulating prices charged by large electricity lines businesses in New Zealand. There are 29 such businesses, each of which operates as a regional monopoly. Under the 2001 legislation the Commerce Commission became the regulator of the electricity distribution industry and was required to put in place, as soon as practicable, a new regime for its regulation.[1] A feature of the regime is that it is designed to impose price control only on those businesses which require control. The Commission is required to set thresholds which, if breached by lines businesses, may lead to a declaration of control by the Commission, but only following a process in which both the lines business concerned and interested parties may make submissions.

[2] On 31 March 2003 the Commission announced its decision to set an initial price path threshold covering a period that was backdated to commence on 8 August 2001 and run to 31 March 2004. On 23 December 2003 it announced a revised threshold which would take effect from 1 April 2004. Each decision was later formally implemented by Gazette Notice.

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[1] The scheme, which is set out in Part 4A of the Commerce Act 1986, was introduced by the Commerce Amendment Act (No 2) 2001 which came into effect on 8 August 2001.

[3] The appellant, Unison Networks Limited, is the owner of large electricity lines businesses and had made submissions to the Commission outlining its position during the threshold setting process. Unison was dissatisfied with the decisions and increased its prices, thereby putting itself in breach of both thresholds. It brought a judicial review proceeding against the Commission on 17 May 2004 in which it argued that the Commission had set the thresholds in a manner that was inconsistent with the purpose and requirements of the legislation. Unison sought orders setting aside the Commission's two threshold decisions and an order requiring the Commission to reach fresh decisions in accordance with directions to be given by the Court.

[4] Unison was unsuccessful in the High Court, which dismissed its application.[2] It appealed to the Court of Appeal,[3] which found that the initial threshold had been set in breach of the Act's requirements, but that the second threshold had not. By a majority, the Court of Appeal refused to grant Unison any relief in respect of the unlawfulness of the first threshold and dismissed the appeal. Unison now appeals to this Court against that judgment. The Commission supports the outcome in the Court of Appeal. It also supports the Court of Appeal's order on the additional ground that the Court was wrong to find that the first threshold was set in breach of the statutory requirements.

The issue in the appeal

[5] The issue before this Court is whether the initial and revised thresholds are unlawful. Unison's position is that the Commission's statutory power to set thresholds has not been exercised in accordance with the statutory purpose of promoting the efficient operation of electricity distribution markets. It also says that the thresholds do not comply with the requirements for setting thresholds in the statutory scheme, of which thresholds form a central part. Unison argues that the thresholds screen businesses on a basis that is irrelevant to whether those in breach

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2 *Unison Networks Ltd v Commerce Commission* (High Court, Wellington, CIV 2004-485-960, 28 November 2005, Wild J).

3 *Unison Networks Ltd v Commerce Commission* (Court of Appeal, CA 284/05, 19 December 2006, Hammond, O'Regan and Ellen France JJ).

of them should be made subject to price control and in fact might miss those that should be subject to control.

Part 4A of the Commerce Act 1986

[6] The electricity distribution industry in New Zealand comprises businesses which operate as natural monopolies in the regions they respectively serve. As monopolies, these businesses were in a position to exploit their market power by choosing to raise prices above what would be a competitive level, permitting costs to rise, or deferring investment or innovation in their business operations, without risk of adverse consequences from competitors. Prior to 2001 the principal incentive not to act in this way was the prospect that price control would be imposed on the industry by the government following an inquiry under the general scheme of Part 4 of the Commerce Act 1986.

[7] A ministerial inquiry into the electricity industry which reported in 2000 expressed concern that the industry did not regard the imposition of price control under the Part 4 regime as a credible threat. The inquiry also concluded that control under Part 4 was not a suitable means of regulation of the industry. This led to legislation being introduced and enacted which provided for a new regulatory framework for the industry.

[8] As indicated, Part 4A of the Commerce Act came into effect on 8 August 2001. It imposed a specific scheme of pricing regulation applicable solely to the electricity distribution and transmission industry which supplanted the Act's general scheme for control of goods and services in markets in which competition is limited.[4] The regulator is the Commerce Commission,[5] which is given power to decide if goods or services supplied by a large electricity lines business, in markets directly related to electricity distribution services, are to be controlled.[6] The

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4 Contained in Part 4 of the Act.
5 Sections 57DA and 57F.
6 Section 57F.

Commission also administers the control regime under Part 5 of the Act. Large electricity lines businesses (lines businesses) are distinguished from small such businesses in Part 4A by reference to the total circuit length of their electric lines, the volume of electricity conveyed over their lines, the number of consumers and whether their lines are connected to the national grid.[7]

[9] The key features of the regime are set out in subpart 1 of Part 4A, which is headed "Controlled goods or services". Section 57E is a purpose provision which applies to the subpart. It will be necessary later to address s 57E but at this point it is sufficient to say that it expresses a general purpose of promoting the efficient operation of electricity distribution markets for the long term benefit of consumers. It also states that this is to be achieved by targeted control. The benefits are to be obtained by ensuring there are limits on the ability of lines businesses to extract excessive profits, that they face strong incentives for efficiency and quality and that they share the benefits of efficiency gains with consumers including through lower prices.

[10] The Commission was required to start putting the regime in place "as soon as practicable" after the commencement of subpart 1.[8] Following consultation with interested parties it first had to set "thresholds for the declaration of control" of lines businesses and then publish them.[9] The Commission also has the power to reset thresholds from time to time, applying the same process. Thresholds are a key feature of the process whereby the Commission decides whether to impose control on particular lines businesses.

[11] The Commission must assess all lines businesses against the thresholds in order to identify whether any are in breach. In the case of a breach, the Commission must determine whether the goods and services supplied by any businesses in breach are to be controlled.[10] In doing so it must follow a process which involves publishing any intention that it forms to impose control and then hearing, and having

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7 Section 57D(1).
8 Section 57G.
9 Section 57G(1).
10 Section 57H(1).

regard to, the views of interested persons.[11] The Commission's decision on whether or not to impose control must take into account the purpose of subpart 1.[12] If it decides not to impose control it must publish its reasons.[13]

[12] To facilitate the administration of the regulatory scheme, the Act provides for mandatory disclosure of information and the review of the asset valuation methodologies of the lines businesses. Under these provisions the Commission requires large line owners and large electricity distributors to disclose detailed information concerning their businesses. The purpose of the disclosure regime is to promote efficient operation by ensuring that the owners and distributors make reliable and timely information about the operation and behaviour of their businesses publicly available.[14] The Commission must also carry out a review of valuation methodologies for what the Act calls "line business system fixed assets" as soon as practicable after Part 4A comes into effect.[15] The stipulated process allows for submissions by interested parties.

[13] The effect of a decision of the Commission to impose control on a business is that controlled goods and services can thereafter only be supplied in accordance with an authorisation.[16] There are provisions in Part 5 of the Act providing for authorisation of prices, revenue and quality standards of controlled goods and services.[17] Offence provisions and provisions for enforcement by injunctions also apply under Part 6 of the Act.

[14] This scheme for potential control of large lines businesses can be contrasted with the general regime for controlled goods and services under Part 4 of the Act. Those provisions enable goods and services to be controlled through an Order in Council on the recommendation of the Minister. The Minister must be satisfied that competition is limited or likely to be lessened in the relevant market and that control

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11 Section 57I.
12 Section 57H(c).
13 Section 57H(d)(ii).
14 Section 57T.
15 Section 57ZD.
16 Sections 57J and 55.
17 Sections 70 and 70B of the Act, which also apply where price control is imposed under Part 4 of the Act.

is necessary or desirable in the interests of those who acquire the goods or services.[18] The role of the Commission in relation to decisions on whether price control is to be imposed is merely to report to the Minister when requested or on its own initiative.[19] Once control is imposed, it is administered by the Commission through the generally applicable authorisation provisions.

Decision-making process

(i) Initial threshold

[15] The Commission took over eighteen months from the time that Part 4A came into force to determine initial thresholds for declaration of control of electricity lines businesses. The Act requires that its process be an open one and the Commission consulted extensively with both lines businesses and electricity user groups during the process. Its senior counsel, Mr Dobson QC, aptly described its approach as an iterative one. We confine our description of the process to matters relevant to the issues in the appeal.

[16] In March 2002 the Commission published an initial discussion document. This summarised the statutory requirements for setting thresholds and outlined options involving various combinations of the elements of efficiency, profit, sharing of profit and quality of service. The discussion paper also referred to international practice in regulatory approaches to ensuring that profits were not excessive. These approaches tended to be based on setting initial prices, and then limiting price changes over a period to the rate of inflation, determined by an appropriate index such as the Consumer Price Index (CPI), less a percentage factor characterised as X. The approach is known as CPI – X regulation. Both the initial prices and the X efficiency factors would be fixed to reflect anticipated efficiency gains over the period, which would typically be five years.

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18 Section 52.
19 Section 56(3).

[17] One of the two most common methods of regulation overseas is a cost based building blocks approach, with allowance for weighted average cost of capital. It was, however, seen by the Commission as costly, intrusive, and requiring a relatively high volume of information to be collected and analysed in determining what components would be allowed. The other common approach required that appropriate levels of prices and permitted rates of change be determined through such techniques as total factor productivity and benchmarking. The Commission's preliminary view was that the information available to it at the time was inadequate for implementing either of these approaches.

[18] The Commission also reported in the discussion document that, on average, standard domestic line charges had increased by only 0.3% in nominal terms in the two year period prior to Part 4A coming into force. This equated to a 5.2% price reduction over that period in real terms.

[19] The Commission foreshadowed that in its first threshold decision it would probably set a threshold price path which it would anchor to the existing prices of each business. It recognised that by signalling its intentions on starting prices for the initial threshold, it risked creating incentives for price increases to be implemented prior to commencement of the threshold, as a buffer against future reductions. The Commission addressed this potential for "gaming" by indicating that any increases after Part 4A had come into force would be subject to the initial threshold unless a business could justify the increase.

[20] The Commission called for submissions on its proposals and convened a six-day conference at which submissions received from the industry and consumer groups were presented and discussed. One theme, which was common to a number of consumer and industry submissions, was that the Commission might set initial thresholds for the first year while more information was gathered and longer term thresholds were designed.

[21] In a draft decision issued on 31 January 2003 the Commission discussed possible efficiency factors. The Commission had evidence that a business operating efficiently and earning a normal rate of return should be able to improve productivity

over the next five years by 1% per annum, in addition to economy wide improvements which would be reflected in the CPI. At that stage it contemplated that there would also be two additional efficiency (X) factors, higher than 1%, for businesses not operating efficiently and/or earning excessive profits. The Commission also said that it had information which indicated that productivity growth in the utilities sector had been of the order of 4% from 1986 to 1998 and 4.7% from 1993 to 1998. From this evidence it concluded that there had been strong and consistent productivity growth in the sector, of which the electricity distribution industry formed part for a long time, particularly during recent years.

[22] The Commission was also aware that some businesses had recently reduced costs while holding prices in nominal terms for extended periods. It saw this pattern as consistent with setting the efficiency factor X at 2% to 3%. Its assessment was that on an industry-wide basis annual efficiency gains of between 1% and 5% were possible. It acknowledged that the ability of individual lines businesses to reduce prices would differ.

[23] The Commission then received submissions on what by then were specific proposals. These included a joint submission on behalf of 18 distribution businesses that supported an initial price threshold in which X was equal to the CPI, meaning that no increases were provided for by the threshold. Others agreed. Unison itself suggested that this would put a regime in place quickly while allowing work to be done on appropriate benchmarks with the results feeding into a revised threshold in 12 months. The Commission announced its decision on the initial threshold on 31 March 2003. It was formally implemented by a Gazette Notice on 6 June 2003.[20]

[24] In its decision the Commission set an initial threshold under which the average prices of lines businesses during the period from 8 August 2001 to 31 March 2004 were not to exceed their prices at the commencement of that period. Assessments would be made as at 6 September 2003 (three months following the date of the Gazette Notice) and 31 March 2004. It was expected that the price path would be reset in a revised threshold effective from 1 April 2004 for a five-year

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[20] Commerce Act (Electricity Lines Threshold) Notice 2003.

period, and thereafter annually. Subsequent resetting would follow periodic benchmarking exercises and be based on detailed information concerning the costs and operational performance of lines businesses, which they would be required to provide in a standard form. The Commission indicated that when resetting the price path for businesses in 2004 it would have regard to expected efficiency gains in the industry.

[25] The Commission emphasised that breach of a threshold did not necessarily mean that a business should be placed under control. Rather, breaches would identify those businesses whose behaviour might be inconsistent with the purpose provisions in Part 4A of the Act, giving cause for the Commission to investigate their circumstances.

[26] The initial threshold price path was set in terms of the formula (CPI – X). X was set at the CPI for all businesses during the initial threshold period, effectively imposing a price freeze from 8 August 2001 on lines businesses which did not wish to put themselves in breach. The threshold, in other words, operated as an incentive for lines businesses to ensure that, when they were assessed, their average prices had been kept at the same level during the period since the legislation came into force.

[27] The initial price path threshold was supplemented by a separate threshold in relation to the quality of the service provided by lines companies. No dispute is before us concerning the quality thresholds and it is unnecessary to refer to them further.

(ii) Revised threshold

[28] Following the 31 March 2003 decision, the Commission undertook a similar process for resetting the threshold that would take effect from 1 April 2004. A discussion paper was published on 30 May 2003. It proposed retention of the CPI – X formula for the second price path threshold. The discussion paper favoured an option which would set X factors by a comparative approach. It would be based on a comparison of the prices of the respective businesses rather than their profits and productivity. The alternative was a partial building blocks approach which included

a profit adjustment. It would have involved the Commission exercising judgment on profits or business inputs including operating costs. The alternative was less favoured as a basis for setting the threshold, partly on grounds of cost. The Commission indicated that profitability could be taken into account during a post breach inquiry into specific businesses. Submissions were sought and received from industry and consumer groups as had happened during the first stage. Most submissions from the industry favoured the Commission's preferred approach.

[29] The Commission also engaged the consultancy firm Meyrick and Co as its specialist advisers on the process. Meyrick's advice to the Commission was recorded in a report dated 3 September 2003. In its submissions Unison had contended that a profit adjustment should have been incorporated in the revised threshold. In its report Meyrick considered the advantages and disadvantages of such an adjustment. Meyrick said:

> Profitability issues are often addressed separately from productivity issues by the setting of a 'P_0' factor separately from the X factor. While the X factor is based on relative productivity considerations as usual, the P_0 adjustment is applied as an additional adjustment in the first year of the regulatory period to bring the business's profitability back to 'normal' levels. P_0 adjustments have been the subject of much controversy in other countries. By sometimes placing a large adjustment burden on the distributor in a short space of time there is a risk that this process can place undue financial distress on the lines business and endanger the ongoing security of supply. They also assume that the regulator has full information which is rarely the case.
>
> A more reasonable approach to addressing the profitability problem is setting a 'glide path' where prices are adjusted over a period of several years to bring the business to a position of earning a normal return. The overall X factor that a business is set will then consist of two components: the usual productivity-based component plus an additional component aimed at gradually eliminating excess profits or restoring normal returns, as the case may be.

[30] The Commission departed somewhat from its preferred approach in its draft decision of 5 September. It said that it intended to use a comparative approach in setting the X factor but would take into account both productivity (cost efficiency) and relative profitability of individual businesses. It said that it recognised that businesses with higher rates of return would have scope for implementing price reductions. Further, and relevant to Unison's concern, it recognised that there was a need for businesses which had been maintaining low prices to be able to increase

their prices by more, relative to others, before they would breach the price path threshold.

[31] Following receipt of further submissions, the Commission published its decision on the reset threshold on 23 December 2003, to take effect from 1 April 2004. A Gazette Notice was published on 31 March 2004 giving formal effect to the decision.

[32] In its announcement the Commission confirmed that it was retaining the (CPI – X) formula and setting X factors for businesses having regard to the financial information each had disclosed concerning their performance for the period ending 31 March 2003. The X factor was determined by a sub-formula (B + C), where B was a positive figure, representing the Commission's assessment of expected improvements in efficiency industry-wide, and determined through total factor productivity analysis. The same figure for B would apply to all businesses. Each business would be assigned a different value as its C factor. It would have two components, the first relating to relative productivity (cost efficiency) of each business, and the second to its relative profitability. We refer to these as C1 and C2 respectively. The Commission acknowledged it might need to assign a negative C factor to those businesses that had been maintaining low prices. This reflected the submissions of a number of businesses, including Unison, which had historically been owned by customers. A negative C factor would enable those businesses to increase their prices by more relative to others, while remaining within the price path.

[33] Businesses were allocated a C1 factor according to whether their productivity was above average, average or below average with values of +1, 0 or –1 respectively. The businesses were allocated C2 factors according to average profitability. Those which had set comparatively low prices were assigned a –1% value and those with comparatively high prices a +1% value. All others received a value of zero. The final C factor was derived by combining the allocated productivity and profitability components.

[34] All but three of the lines businesses received a (combined) C factor of –1%, 0% or +1%. The three other businesses each had relatively high productivity but relatively low returns. As a result their composite C factor was –2%, facilitating increases in their average prices to more sustainable levels. The process resulted in X factors which ranged from –1% to +2%.

Unison's position during the process

[35] To complete this description of the process it is appropriate to elaborate on the position Unison took during the consultation process. Unison expressed concern early on that its profitability during the period since 8 August 2001 was less than that of businesses owned by private investors. This was, as Unison saw it, because it had historically charged customers lower prices as a consumer trust-owned business. Unison supported the inclusion of a profit element in the initial threshold X factor to enable it to address what it saw as its anomalous situation.

[36] Unison was, however, at all times in a minority within the lines industry in seeking a profit adjustment. Most businesses were associated with submissions that sought an initial threshold which did not have a profit component. These other businesses emphasised the advantage of putting in place a uniform X factor for the initial price threshold in order to establish promptly the basis for development of a regime of targeted control. This approach would not lead to an immediate price adjustment, but gradual adjustments would result over time once the thresholds had been reset.

[37] In its own dialogue with the Commission, Unison appears to have recognised, at least in principle, that such an approach would be feasible, but emphasised its view that those businesses which felt they had a case for breaching the price path, for reasons related to maintaining their efficiency, should be able to do so. As indicated, the Commission's initial threshold decision fixed initial prices on the price path and the X factor for the initial threshold without allowing for any profit adjustment.

[38] In the revised threshold decision of 23 December 2003, Unison's C1 productivity factor was 0%, and its C2 profitability factor was –1%, so that its

composite C factor was –1%.[21] This cancelled out the +1 value of the B factor. Unison was accordingly assigned an X factor of 0% in the (CPI – X) formula. The effect was to restrict Unison's increases in its prices over the five year period after 1 April 2004 to consumer price index movements, unless it was prepared to breach the threshold.

[39] All lines businesses then presented compliance statements in respect of their own assessments against price path and quality thresholds. As a result of price increases on 1 March 2004 Unison breached the price path threshold by $10.98 million, or 23% of notional revenue. This put Unison in breach of both the initial and the revised threshold. As noted above, Unison issued judicial review proceedings challenging the Commission's decision on 17 May 2004.

High Court and Court of Appeal judgments

[40] In the High Court Wild J decided that the legislation permitted the regime that the Commission had designed for the two thresholds. Section 57E, the purpose provision, was expressed in language ("promote" and "targeted") which was consistent with approaches to achieving the objectives through encouragement and persuasion even though that would take time.

[41] Wild J was also concerned that Unison's view of the attributes each threshold must have gave the means priority over the ends in the interpretation of the statutory purpose. The Judge also was satisfied that the Commission had sought throughout to establish a regime which gave effect to the stipulated purpose. It was also open to the Commission to conclude that, while a profit adjustment might immediately remove excess profits earned by efficient companies, it might also impose undue financial stress on a business forced to make large adjustments in a short space of time. As well, making profit adjustments would have been more time consuming than the approach taken in the revised threshold and would lead to delay. There was a need to introduce thresholds, sooner rather than later, to avoid gaming. Part 4A did

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[21] Unison was the 16th most productive distribution business and the 19th most profitable business.

not have to be read as requiring that thresholds be based on profit levels of businesses.

[42] The Court of Appeal recognised that the Commission had a wide discretion as to how it set thresholds. The Commission accordingly did not have to achieve all elements of the statutory purpose under s 57E(a), (b) and (c) at once. The Court accepted that the Commission might be able to achieve the purposes in numerous ways and could frame the thresholds in a manner which operated as incentives for lines businesses to act in a way that would attain the statutory objectives. Nevertheless, the Court decided that the Commission's approach in setting the first threshold had been unlawful because it had not given adequate emphasis to certain requirements of the legislation.

[43] First, the initial threshold had not provided a filter that attempted to identify businesses which were plainly candidates for control. Because lines businesses were immune from control unless they were in breach of what the legislation referred to as a "threshold for control", the Act envisaged that there would be some filtering at the threshold stage, rather than leaving all work of that kind to be done during the post-breach inquiry. The reference in the Act to achieving the statutory purpose through "targeted control"[22] and the Minister's statement to the House of Representatives that businesses would be chosen for investigation according to criteria,[23] were referred to as supporting the Court's interpretation of what the Act required.

[44] Finally, the Court of Appeal drew on the context of the general price control provision of Part 4 of the Act where thresholds operated to "assist" the Minister to decide whether control should be imposed.[24] This indicated that Parliament had in mind that there would be sufficient precision in a threshold under Part 4A to satisfy the regulator that a complying business did not need to be subject to price control.

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22 Section 57E.
23 Hon Pete Hodgson, Minister of Energy (25 July 2001) 593 NZPD 10412.
24 Section 54(1).

[45] The Court of Appeal concluded that:[25]

> [T]he statutory purpose of the threshold is to perform a screening or filtering function, which, over time, should capture those who are potential candidates for control. The statute does not require anything more than a rough approximation and, in assessing compliance with the statutory purpose, the incentive effects of the threshold will be relevant.

[46] The Court of Appeal also pointed out that under the initial threshold an inefficient and high charging business could avoid becoming potentially subject to control despite maintaining monopoly pricing and a low quality of service during the stipulated period. The initial threshold did not screen for those factors at all and indeed would, in the Court's view, be a disincentive to achieving the objectives expressed in s 57E(a), (b) and (c). The Court recognised that its view of what the statute required meant that the Commission would face delays putting an initial threshold in place, but said that the problems the Commission faced at the outset could not make lawful a threshold regime which did not meet the statutory purpose.[26] The nature of subsequent thresholds did not alter this situation.

[47] In relation to the revised threshold, the Court of Appeal remained concerned that the worst performers might still be missed, because those businesses would still be able to evade control while operating within their price path. By this time the Commission did, however, have information to support its view that no business in the worst performing category was being missed. The Court accepted that over time the revised threshold glide path would constrain businesses in their ability to extract excessive profits, and would provide associated incentives to improve efficiency while prices were decreasing in real terms. Lower prices would also lead to consumers' sharing in efficiency gains. The Court referred to the Meyrick report as providing support for the Commission's glide path approach and as highlighting the difficulty in effectively addressing productivity issues within a short timeframe. The Court was also conscious that thresholds could be changed from time to time and reset if new information indicated that the thresholds were not catching businesses making excessive returns.

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25 At para [46].
26 At paras [60] – [62].

[48] For these reasons the Court held that the revised thresholds were lawful.

Were the thresholds set lawfully?

(i) The question for the Court

[49] The question for this Court is whether the Commission has failed to exercise its power to set thresholds in accordance with the purpose and the requirements of the Act. Unison contends that the Commission's decisions setting initial and revised thresholds are invalid because, in reaching them, the Commission abused its statutory powers. Unison says, first, that the Commission set the thresholds for an improper purpose and, secondly, that the Commission misconstrued the requirements of the legislation and in consequence applied the wrong legal test in exercising the threshold setting power.

(ii) The limits of public power

[50] As is often the case, the two grounds relied on to show invalidity overlap to a considerable extent.[27] While we will address each, in the end, the common ultimate question is whether the Commission exercised its powers in accordance with the requirements of the statute. It must act within the scope of the authority conferred by Parliament and for the purposes for which those powers were conferred.

[51] Public bodies must exercise their statutory powers in accordance with the statutes which confer them. If they make decisions that are outside the limits of their powers they abuse them. The courts control any misuse of public power through judicial review.

[52] It is unnecessary in this case to attempt a comprehensive description of all circumstances in which the exercise of a statutory power will amount to an abuse. Two conventional instances have been raised for consideration. The first is where

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[27] Joseph, *Constitutional and Administrative Law in New Zealand* (2nd ed, 2001), para [21.2.4].

the power is exercised for a purpose that is not within the contemplation of the enabling statute. The second, to which we will return, is where the decision-maker applies the wrong legal test in exercising the power.

[53] A statutory power is subject to limits even if it is conferred in unqualified terms. Parliament must have intended that a broadly framed discretion should always be exercised to promote the policy and objects of the Act. These are ascertained from reading the Act as a whole. The exercise of the power will be invalid if the decision-maker "so uses his discretion as to thwart or run counter to the policy and objects of the Act".[28] A power granted for a particular purpose must be used for that purpose but the pursuit of other purposes does not necessarily invalidate the exercise of public power. There will not be invalidity if the statutory purpose is being pursued and the statutory policy is not compromised by the other purpose.[29]

[54] Ascertaining the purpose for which a power is given is an exercise in statutory interpretation which is not always straightforward. This is partly because legislative regimes differ in the specificity with which they grant powers. In this area the courts are concerned with identifying the legal limits of the power rather than assessing the merits of its exercise in any case. They must be careful to avoid crossing the line between those concepts.

[55] Often, as in this case, 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.

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28 *Padfield v Minister of Agriculture, Fisheries and Food* [1968] AC 997, at p 1030 per Lord Reid.

29 *Attorney-General v Ireland* [2002] 2 NZLR 220 at paras [42] and [43] (CA); *Poananga v State Services Commission* [1985] 2 NZLR 385, at pp 393 – 394 (CA).

(iii) Were the limits exceeded?

[56] In deciding whether the limits were exceeded in this case, it is necessary to start with the statutory provisions in relation to thresholds and their place in the statutory scheme of control of lines businesses under Part 4A. The power to set thresholds is given in s 57G as follows:

> **57G Thresholds for declaration of control**
>
> (1) The Commission must, as soon as practicable after the commencement of this subpart, and may from time to time—
>
> > (a) consult with participants in the electricity distribution and transmission markets and with consumers as to possible thresholds for the declaration of control in relation to large electricity lines businesses; and
> >
> > (b) set thresholds for the declaration of control in relation to large electricity lines businesses; and
> >
> > (c) publish those thresholds in the *Gazette*, on the Internet, and in any other manner (if any) that the Commission considers appropriate.
>
> (2) Thresholds can be expressed in quantitative or qualitative terms.

[57] The setting of thresholds is the first of three steps in the regime for imposing targeted price control. The next two steps, and the process to be followed when taking them, are outlined in s 57H:

> **57H Process for making decisions on declaration of control**
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> The Commission must—
>
> (a) assess large electricity lines businesses against the thresholds set under this subpart; and
>
> (b) identify any large electricity lines business that breaches the thresholds; and
>
> (c) determine whether or not to declare all or any of the goods or services supplied by all or any of the identified large electricity lines businesses to be controlled, taking into account the purpose of this subpart; and
>
> (d) in respect of each identified large electricity lines business,—
>
> > (i) make a control declaration; or

> (ii) publish the reasons for not making a control declaration in the *Gazette*, on the Internet, and in any other manner (if any) that the Commission considers appropriate.

Section 57H contains no explicit directions to the Commission in relation to how it should assess business operations against thresholds in order to identify those businesses in breach. That clearly is a matter that is left to the Commission. In determining whether an identified business is to be subject to price control, however, the Commission is directed to take account of the statutory purpose.

[58] Sections 57G and 57H form part of subpart 1 of Part 4A of the Act. The subpart has its own purpose provision. Section 57E provides:

> **57E Purpose**
>
> The purpose of this subpart is to promote the efficient operation of markets directly related to electricity distribution and transmission services through targeted 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, including through lower prices.

[59] As earlier mentioned, s 57E expresses both the general purpose of subpart 1 and the manner in which it is to be achieved. Accordingly, price regulation under subpart 1 of Part 4A is to operate in a way that promotes efficiency in the operational performance of individual lines businesses through the mechanism of "targeted control" for the long term benefit of consumers. Targeted control is to operate in a way that limits the ability of the lines businesses to extract excessive profits, creates strong incentives for them to increase efficiency and provide services of a quality desired by consumers, and ensures that efficiency gains are shared with consumers. The regime enacted in 2001 is one which seeks to confine the degree of intrusion on industry participants to that which is necessary. While all lines businesses are subject to the regime, the purpose of targeted control is to make only those who require that degree of regulation subject to formal price control. The regime is also intended to create incentives for industry participants to avoid control by operating

efficiently in the long term interests of consumers. It is implicit in s 57H(c) and (d) that control is not to be imposed unless the Commission concludes control of that business is appropriate to achieve the ends of s 57E.

[60] It is, of course, clear that the three stages of the regime will operate together as the mechanism which imposes price control on those lines businesses for which control is appropriate. It is also implicit that the administration of the regime by the Commission should operate in a way that creates incentives for all lines businesses to act in a manner that will contribute to achieving the long term benefits for consumers that are specified in s 57E.

[61] Mr Goddard QC, for Unison, argued that price changes by themselves convey no information about the efficiency of a business. He pointed out that a threshold price path, which is breached whenever a business increases its prices, is not capable of screening particular businesses for inefficiency or excess profitability concerns. We accept these propositions. Mr Goddard also submitted that it followed that if a threshold was to set a price path, it could only meet the purpose of s 57E if there had been adjustments to reflect the initial considerations of profitability and efficiency of the business.

[62] The question which is central to Unison's argument is to what extent does the Act require that thresholds themselves perform functions of incentivising and screening. Mr Goddard made a number of points in support of Unison's perception of what the Act requires. He observed that thresholds are referred to in the Act as "thresholds *for* the declaration of control"[30] and control cannot be declared unless a lines business has breached a threshold. Mr Goddard argued that this provision in the Act for a "safe harbour" indicated that the Commission had to work on the basis that a threshold breach must identify behaviour which shows that the business is not operating efficiently. A threshold therefore had to operate as a screening mechanism which selected those businesses which were behaving in a manner that suggested they were eligible for control. He said that the Act envisaged that thresholds would address each of the ends set out in s 57E(a), (b) and (c).

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[30] Section 57G(1).

[63] Mr Goddard supported this view of the Act by comparing the provisions of Part 4 with those of Part 4A. Under Part 4 Ministers impose control by Order in Council. Under Part 4A the Commission has that power, but it must operate within a more structured process which, counsel said, pointed to a confined discretion. Mr Goddard also noted that the Commission must publish reasons if it decides not to impose control following the breach of a threshold. He said this demonstrated that a breach should signal a serious concern about s 57E ends. Mr Dobson argued that as productivity gains could be achieved over the two and a half year threshold period, it was appropriate to have a nominal price freeze. In response, Mr Goddard said that this argument was not reflected in the Commission's first threshold decision, nor in the affidavit of its Chair.

[64] The most important consideration, however, in ascertaining the limits on the threshold setting power under s 57G is that the section is broadly worded. It is more broadly worded than the power to impose control.[31] As well, the Act does not explicitly stipulate any necessary attributes of thresholds other than to say that thresholds can be expressed in quantitative or qualitative terms. The power is designed to achieve broad economic objectives, stated in s 57E, and is given to a body with expertise in the field. The objectives are to be achieved through a targeted control regime. Subject to any requirements arising as a matter of necessary implication, the Act contemplates that the Commission itself will fashion thresholds that in its judgment are appropriate to further those objectives, having considered submissions from competing interested parties.

[65] The shorthand description of the thresholds in s 57G, as "thresholds for the declaration of control", should not obscure the reality that they are actually thresholds for a mandatory consideration of whether control should be imposed. That characteristic offers no support for the view that thresholds must screen for behaviour raising s 57E concerns, rather than simply contribute in a rational way to the Commission's process. Efficient companies who are found to have breached a

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[31] Section 57H(c). See also s 57M(1) in relation to the power to authorise prices of controlled goods and services.

threshold but which are not charging excessive prices can demonstrate that is so at the third step in the process.

[66] The argument which contrasted Parts 4 and 4A of the Act, and the structural differences in the two regimes, found favour in the Court of Appeal. It is entitled to some weight in the interpretation of Part 4A. The comparison does not, however, provide any significant support for cutting back the ordinary scope of the broad language that expresses the threshold setting power. Part 4A is the more structured scheme of control but that does not indicate anything about the breadth of the power to set thresholds. The requirement that the Commission give reasons for a decision not to impose control following a breach of a threshold is not surprising, nor of interpretative significance, in the context of an open regime for imposing control which encourages participation by interested parties. It does not convey any implication that a breach will give rise to a presumption that there are serious concerns over s 57E ends. In relation to the legislative context we should add that the very general observation of the Minister in charge of the Bill, while the House was in Committee, that businesses will be chosen for investigation according to criteria, has not helped us to clarify the scope of the relevant power under the Act.[32]

[67] Finally, in relation to Unison's arguments, nothing should be inferred from the absence of any reference in the first threshold decision to expected productivity gains in the industry during the first threshold period. The consultative and iterative nature of the Commission's process resulted in a number of matters relevant to what X should be being raised at an earlier stage in a context which makes plain that they formed part of the Commission's underlying reasons for its decisions setting both thresholds.

[68] The 2001 Act required the Commission to consult with industry participants and consumers and set thresholds as soon as practicable after the legislation commenced.[33] It seems hardly consistent with this expression of the need for promptness in getting an effective regime in place that Parliament contemplated that

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32 Hon Pete Hodgson, Minister of Energy (25 July 2001) 593 NZPD 10412.

33 Section 57G(1).

thresholds would only be set when the Commission was in a position to act by reference to the individual circumstances of particular businesses and whether they were demonstrating s 57E concerns. This would require that the Commission first accumulate sufficient information concerning individual companies' operations from the new disclosure regime before it set initial thresholds.

[69] The statutory context gives rise to no necessary implication that narrows the scope of the power to set thresholds in the manner Unison contends. The correct formulation of the implied limits on the scope of the power to set thresholds that arise from the legislative purpose is simply that thresholds must be relevant to that purpose in the sense that they will contribute to the administration of the targeted control regime. In order to contribute to the administration of the targeted control regime it is not necessary for a threshold to do more than identify potential candidates for control on a general rather than a specific enterprise basis. Here breach of the threshold rationally gave rise, in general terms, to the potential need for control. In that way, the threshold contributed to and did not compromise the administration of the statutory regime. There is no suggestion of any ulterior purpose in this case. It cannot therefore be said that the Commission misused its powers when fixing the threshold on the broad basis it adopted. It is at the final stage of the process, when examining a particular business, that the Commission is obliged to take into account all aspects of the statutory purpose of promoting efficiency that s 57E covers. Prior to then, thresholds may legitimately be steps on the way which, in isolation, are not necessarily indicative of individual s 57E concerns.

[70] The Commission's approach in setting the initial threshold was, of course, informed by reference to the industry generally. It had concluded by January 2003 that efficient businesses in the industry should be able to improve their productivity by 1% per annum, in addition to economy-wide efficiency improvements. This conclusion was reinforced by material that later became available to the Commission concerning strong and consistent productivity growth over a lengthy period in the utilities sector. The Commission's view, which it implicitly considered to be a conservative one, was that on an industry-wide basis efficiency gains of between 1% and 5% per annum were possible for the industry. This view was properly

reinforced in the Commission's mind by its acceptance by the majority of the industry. From the information the Commission had about the sector it ultimately formed the view that the price path should commence with existing prices and that X should be the CPI figure in the initial threshold. It was then a rational decision to commence the price path from the time the legislation came into effect.

[71] In those circumstances, to set the initial threshold on a basis that operated as a price freeze provided a relevant threshold. A business which had increased its prices at the dates of assessment might raise s 57E concerns. It is important to emphasise that it is not just the price rise in itself which is significant but that it is a price rise against the background of the information which was available to the Commission when it set the first threshold.

[72] The prospect that some such businesses might justifiably depart from a price path threshold which had been determined having regard to the position of the industry as a whole does not mean the decision on the threshold was irrelevant, or that it was reached for purposes contrary to those of the legislation. The inquiry into whether control should be imposed following breach is designed to address whether price increases of particular companies during the period of the initial threshold were justified in terms of s 57E concerns. There is nothing in the statutory scheme which requires that a company which is operating efficiently should be immune from an inquiry that might result in price control if it breaches a threshold set for reasons relevant to the position of the industry generally.

[73] Once it is established that the first threshold is lawful, the argument of Unison that the second threshold runs counter to the policy of the Act falls away. The second threshold's price path commences at prices charged as at 31 March 2004 which, of course, are those charged at 8 August 2001 when the initial threshold came into effect. For the reasons we have given in finding that the initial threshold was fixed consistently with the purpose of the subpart, that is a legitimate starting point. Thereafter the Commission drew on information received to calculate the X value according to relative productivity and profitability considerations. At this point some allowance was made for businesses which had been maintaining low prices by allowing for the possibility of a negative C factor.

[74] The second ground of Unison's appeal is that the Commission misconstrued the requirements of the legislation and applied the wrong legal test when exercising the power to set the initial and revised thresholds.

[75] Any material error of law by a public body in exercising its statutory powers will be reviewed by the courts.[34] The error of law in this case is said to arise from the Commission's failure to appreciate the individual business focus of the thresholds under the power conferred by s 57G. The argument relied on the context of Part 4A, and to some extent other parts of the Act, as the basis for reading down the largely unqualified language in s 57G concerning the scope of the power.

[76] It will be apparent that the argument on this ground overlaps with that already considered as to the failure to exercise powers for the statutory purpose. The Act is clear that thresholds must be set on the basis that their breach will provide a platform for obtaining information relevant to possible imposition of targeted control as explained in s 57E. To the extent practicable at the time, the thresholds must be appropriate to select businesses whose deviance from the norm may indicate they are behaving in a way that makes it appropriate to give specific consideration to their situation with a view to possible control. To impose any more specific focus would effectively require the Commission to defer bringing the regime into effect. Nothing in the statutory purpose or context points to circumscribing the power to set thresholds any more than is inherent in the foregoing. The statute contemplates that the Commission, as a specialist body, will exercise judgment in constructing thresholds which will contribute to the administration of the targeted control regime.

[77] The requirement that it set thresholds could have been lawfully tackled by the Commission in one of two ways. First, the Commission could have set thresholds which ascertained those companies operating inefficiently and restricted the prices they could each charge by imposing controls. This would have included individual profit adjustments. The difficulties in implementing this approach, due to the time it would take and the resources that would be involved in collecting information, made

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[34] *Bulk Gas Users Group v Attorney-General* [1983] NZLR 129 (CA); *Peters v Davison* [1999] 2 NZLR 164 (CA).

it unattractive. Alternatively, the Commission could seek to set price paths based on the information it had available for the industry as a whole, fine-tuning them through resetting as it became better and more specifically informed. In the early stages such thresholds would simply provide a group, whose breaches might show s 57E concerns, and who would appropriately, on that account, be investigated. Over time such thresholds would squeeze those behaving as monopolists, forcing them to price efficiently and more cheaply and to abandon policies of excessive charging. Both approaches were within the terms of the provisions of the subpart. The Commission's chosen approach for the initial and revised thresholds was the latter one and it was lawful.

[78] For these reasons we are satisfied that the Commission did not err in law as to the scope of its threshold setting power.

Conclusion

[79] The Commission has accordingly acted lawfully in setting both initial and revised thresholds. It is therefore unnecessary to hear argument on the ground concerning refusal of relief. The appeal by Unison is dismissed. Unison must pay the Commission costs in this Court of $25,000 plus reasonable disbursements. Costs in the Court of Appeal and High Court are to be determined by those Courts in light of this judgment.

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