IN THE SUPREME COURT OF NEW ZEALAND SC 12/2007

IN THE MATTER of a Civil Appeal

BETWEEN **UNISON NETWORKS LIMITED**

Appellant

AND

THE COMMERCE COMMISSION

Respondent

Hearing 19 and 20 June 2007

Court Blanchard J
Tipping J
McGrath J
Anderson J
Gault J

Counsel D 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

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CIVIL APPEAL

10.01am

Goddard May it please the Court David Goddard and Liesle Theron for the appellant Unison.

Blanchard J Thank you Mr Goddard.

Dobson May it please the Court Dobson and with me Jason McHerron for the Commission.

Blanchard J Yes, thank you Mr Dobson

Galbraith May it please the Court I appear with Mai Chen and Nick Russell for Vector Limited.

Blanchard J Thank you Mr Galbraith. Well we indicated we'd hear from Mr Dobson first on the question of unlawfulness.

Gault J Yes, just before you begin Mr Dobson, I think I should add to the disclosure of other members that as an Auckland power subscriber I have with my wife a very small number of shares in Vector.

Dobson It doesn't provide a problem Sir. Thank you very much. May it please the Court in anticipating the sequence of issues to be addressed in terms of the guidance that was provided a couple of days ago, I have had placed before Your Honours a single sheet which I hope Your Honours have, indicating the sequence in which I propose addressing the issue of the unlawfulness of the IPPT as found by the Court of Appeal. As Your Honours will probably appreciate from the reading you've done, it's a little difficult to put a narrow boundary around that and I might just take a moment to indicate to the Court the way in which I anticipate that is best addressed in the context of the larger issues in the appeal. If Your Honours feel that goes beyond the part on which you wanted to hear from the Commission first, by all means of course you will surely indicate. So I would subject to any directions from Your Honours, begin with a short sketch of the context of the electricity industry at the time this amendment to the Commerce Act came into effect in 2001; then move to certain statutory interpretation issues on the purpose of subpart 1 of part 4(a) which is the part which we are concerned and Your Honours will see a number of sub-headings there; and then address what are discerned by the Commission as the statutory requirements for thresholds; pull-back next from the legal context to the economic context and endeavour to provide some explanation of what the nature of CPI-X control is and the analogy that one can draw between control and the thresholds with which we are most particularly concerned, and then address I hope only very briefly Your Honours what the relevant legal test to be applied by the Court is for substantive unlawfulness; and finally address in the context of what's gone before, the lawfulness as it is submitted for the Commission of the IPPT as we have acronymanalised the initial price bar threshold, and that involves making submissions to Your Honours as to why the Court of Appeal was in our respectful submission wrong, and in particular pointing out that the finding is inconsistent with that of the Court of Appeal in respect of the revised RPPT. If that's acceptable to Your Honours? Before doing that I seek to just make six short points which encapsulate the Commission's position on the challenge that's been made in these proceedings. The first predictably that the IPPT was lawful in that it did promote the statutory purpose of the subpart in s.57E so that if companies were extracting excessive profits, the initial threshold would begin the process which over time would limit such

companies' ability to extract excessive profits. Also in terms of the 47(e) criteria, the threshold would begin incentivising companies to improve their efficiency and it would begin the process of sharing benefits of any efficiency gains, including by providing lower prices to consumers. So in the literal sense we submit that the threshold did contribute to the promotion of efficient markets in the electricity distribution and transmission in those ways. The second point relatively obvious and short one, an initial set of thresholds had to be set in place as soon as practicable subject to the Commission's power to revisit thresholds thereafter, so there was a timing imperative imposed by the terms of the statute. The third, the Commission was given a broad discretion as to the form of thresholds it designed. There was no one right answer and the design chosen was clearly within the range of lawful options open to it. If I could comment, Unison's criticisms would require a far more company specific form of threshold, involving more detailed research and design work by the Commission before it could be set, and then far more work by all of the companies in responding to it. Now variants such as that contended for by Unison were thoroughly debated and researched in the process of consultation undertaken by the Commission, and in our respectful submission those variants were rejected for quite valid reasons. The fourth short point I wish to make is that the economic opinion evidence on which Unison's challenge is founded, which is from the Economist, Mr Sundakov, is quite different from the proposals advanced on behalf of Unison by another Economist, Professor Ergas, during the period of consultation and it's relevant to that point to observe that the vast majority of the industry and other interested parties supported the design implemented by the Commission. The fifth point, coming to the Commission's response to the finding of the Court of Appeal. With respect the Court of Appeal's finding is essentially one that IPPT did not promote the statutory purpose well enough and it's our case with respect that the Court erred in testing its lawfulness in that way. In contrast the Court of Appeal found that the revised threshold was lawful. Now, as I hope to explain to Your Honours, it shared the same design as the initial threshold and the differences is in the X factor can only be characterised as matters of degree and in our respectful submission consistency should have required a finding that both thresholds came within the statutory purpose. The final short point I wish to make is that accepting with great respect that the practical outcome is not the complete answer in administrative law, but especially in a case where it is substantive unlawfulness that is raised, error does tend to translate into failure to meet the statutory purpose. Here with great respect the threshold breaches have identified companies that warranted closer consideration and those are altering their behaviour; that is after all the ultimate aim of the part of the Act. There is no rogue company identified, no rogue companies that are out of step in some major way that have not been caught by the thresholds. Now with those introductory comments, unless there are questions from

Your Honours, I'll move to the first of the six points in sequence that are outlined in the single page, namely the industry context at the time the Act came into effect. I'll start with the fairly obvious point that all the companies subject to this regime are natural monopolies of a type regulated as a matter of course in all comparable jurisdictions to New Zealand. New Zealand is by this Act embarking on a unique experience of what's been loosely described as light-handed regulation, so that if we compare the position in all of the Australian States, the United Kingdom, United Stated, utilities such as electricity distribution businesses are regulated in some form as a matter of course. There is another unusual feature about the industry in New Zealand and that is its exceptionally widespread ownership and the range of sizes of the businesses. There are 28 distribution businesses plus the transmission entity Trans Power, which is also covered by this regime, serving our population of somewhat more than 4 million. The businesses range in size from customers as small as 4,000 to 640,000 customers, and Your Honours may have noted in the High Court judgment the Judge picked up the comparison which we made with the United Kingdom where seven businesses operating in 14 franchises service 58 million people, so the prospect of regulation is a different one in the New Zealand environment because of the dynamic industry - small size, large diversity of ownership. The variety of ownership structures deriving from historical context, Your Honours will probably be aware that we had Electricity Power Boards which were effectively local authorities and the reform process in the 90's transformed them into the model we now have. Prior to the Act there had been an enquiry into the conduct of Lines businesses, which concluded that the general price control provisions in the Commerce Act were not seen as a constraint on their behaviour. They weren't operating as an effective constraint and that enquiry's recommendations included that there ought to be targeted control but that universal control was not warranted. Part of the context as well at the time is that the advice to Treasury concerning past productivity performance in the electricity sector, and observations concerning the average changes in line charges both implied that sectoral productivity was improving on average by close to the rate of inflation, so that in the period of the enquiry which covered 1999 to 2001, whilst these businesses were unregulated they were making efficiency gains at about the rate of inflation. So it was in this context that Parliament charged the Commission of setting thresholds as soon as practicable as one component of what was to become a unique targeted control regime.

Gault J Can I ask you a question please Mr Dobson?

Dobson Certainly Sir.

Gault J In that enquiry that you've just been describing, were there any findings of abusive or monopolistic behaviour in the industry?

Dobson There were concerns across the sector of the ability to exercise monopoly power, but I will have to come back to Your Honour as to whether there were specific findings of instances of it that caused concern. I'm sorry that's a detail that I don't have to hand.

Gault J Thank you.

Dobson I would be grateful Your Honours if we could now turn to the terms of the Act. If Your Honours don't have it otherwise, it's in Unison's first volume of authorities at tab 1. Starting with the purpose statement articulated in s.57E. We'll need to come back to this a number of times during the hearing but Your Honours will see that the purpose is explicit as being 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 the suppliers – and then we've got these three characteristics (a) are limited in their ability to extract excessive profits; (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.

Tipping J But those points being joined by 'and' doesn't suggest does it that they're all inter-linked. They can be viewed individually although there may be some inherent overlap. But you can go for one as your primary target presumably while you don't, while you're overlooking (b) and (c), you could go for (a) as a discrete step if you like. Is that the way the Commerce Commission would wish one to look at it?

Dobson Well the Commission has taken its task Sir as having to promote all of those. Promote of course being a qualitative rather than absolute task.

Tipping J The step you're taking now presumably is for you. You could say look while we're promoting everything we'll look at (a) for example as our first priority if you like.

Dobson And if there is a tension between the attribute that would be served, the Commission would be inclined to say well which attribute is to be given priority depends on which most promotes the long-term benefit of consumers, because the part in the chapeau, the bit at the top, is seen as directing the Commission's discretion as to how it makes value judgments between those specific components.

Tipping J Perhaps my point can be put by you in what physical step you take by way of threshold, you don't have to be sort of promoting each of them equally.

Dobson No you don't.

Tipping J In the first instance if you like.

Dobson No, and that is demonstrated Sir by the form that was provided. The parts that we don't have to be concerned about by and large are quality thresholds. Now of course facing strong incentives to improve efficiency can be done by a constraint on prices because if you're not allowed to put your prices up and you want to maintain your level of earnings, you've got to get more efficient. But then at a quality that reflects consumer demands is difficult to measure simply by reference to price and hence the decision of the Commission to have a separate threshold-measuring quality.

Tipping J But for example the sharing. You can have a purpose of sharing but you can't share until you've actually got benefits.

Dobson Absolutely, absolutely Sir, and that's another of the tensions that has to be resolved in the Commission's discretion, because the classic conflict is that if you give priority to lower prices and you force the companies to lower their prices too severely, then you provide a short-term benefit to the consumers because they enjoy lower prices in the short-term, but you may do it to an extent that threatens the viability of the business long-term, and therefore the way the Commission has approached it is that the priority should always be given to the step which is best promoting the long-term benefits of consumers, and of course a point I wanted to make in a moment, but might as well now is that that is entirely consistent with the Act overall, because that's the essence of the purpose of the Commerce Act overall in s.1A

Gault J I take the point about prioritising, but is it not the case that (a), (b) and (c) each conditions would prevail if there was a competitive market in this area?

Dobson Absolutely, yes and that's again

Gault J And doesn't it follow therefore that by the statute and looking to ensure that suppliers operate in those conditions that each of them is important

Dobson Yes.

Gault J Even if some have to be prioritised by the Commission?

Dobson Yes, and the point I want to come back to Sir is that in all the Commission's conduct under this subpart, given that those three are seen as intended to mimic what would happen in a competitive market, then the Commission steps should be also intended to further a mimicking of

competitive pressure even though these are natural monopolies where there is no competition.

Gault J Yes.

Dobson Yes. Now just the first point about 57E, the Commission disagrees with Unison when Unison says that the purpose is solely to ensure that companies act consistently with A to C, and the reason why that's rejected is really reflected in the answers I have to Your Honour Justice Tipping that the whole of the 57E purpose statement has to be had regard to and the specific application, or specific initiatives that might address one or more of A to C have to be measured against the very important explicit purpose at the top and the ultimate goal of advancing the longer term benefit of consumers. Now there are several indications of the breadth of the discretion left to the Commission, and here if I could first contrast part 4(a) with the structure of part 4, where the ultimate power to control companies should that be necessary is vested in the Minister, and that's the pattern elsewhere in the Act. So that fact that the Commission is left to its own devices throughout the whole process up to and including control, plus the broad terms in which the powers are expressed, and the notion that the aim of this subpart is to promote changes in behaviour, and that the behavioural conditions in those to A to C features is where the Commission is to ensure promotion – they are qualitative; they're not absolute; it must not achieve something by a deadline; it does not have a position of absolute control, and all those discretionary elements of the power given to the Commission in our submission amply justify the findings in both the Courts below that the Commission's task under 4A are indeed left to it on broad discretionary terms. It's the expert regulator. Could I focus just for a moment Your Honours on this notion of targeted control? The distinctive feature of this regime is that it is targeted. The Commission would submit that simply means not universal, which is in contra-distinction to the norm in other jurisdictions. It sensibly reflects that there is a significant cost attached to control which always of course is ultimately borne by the consumers, and where we've got 28 companies, the work to control them all if the control regime adopted overseas models might well risk outweighing the long-term benefits, i.e. the regulation would cost so much that it would be less advantageous in the long-term to the consumers than the advantages they might get from the control. And of course the notion of it being targeted contemplates that some, not all, even the majority of companies may never need controlling, so it's targeted in that sense as well. It's targeted because the work of the Commission is in promoting efficient operation. It's in the nature of encouraging more efficient outcomes, not forcing them on the monopoly businesses. It's also important in this notion of targeted control that it's to occur over a period of time and that the pursuit of the objectives will take time. Now I don't often want to take Your Honours directly to the

Commission's written submissions, but this is one aspect on which I think is just efficient if I quickly take Your Honours if I could please through para.59 of our written submissions. Your Honours will see in para.59 that we've set out a number of indications that the achievement of the statutory purpose was intended to be incremental over time, and if I could just quickly run through them. The first is unlike lots of changes of the law 'Parliament envisaged an initial period where there would be no thresholds in place so there would be no operation in the direct sense of the Act. The Commission could only set thresholds once it had consulted with the industry, but was to do so as soon as practicable, so it was recognised there had to be an introductory period where the regime wasn't in force. And then if there is a breach there is quite an extensive consultation process required of the Commission before it can make any control decision, so again there's a passage of time needed to be invested to achieve an outcome consistent with the purpose of the subpart. Then importantly Your Honours will see in s.57K that the Commission is authorised to prioritise a practical recognition that if it found a state of significant breach across a large number of companies, the Commission can, having regard to the purpose statement in 57E, prioritise the ones that it pursues. And that again suggests that the achievement of the aims will take time. Fourth, and this is a point I need to come back to in another context, the information disclosure regime in subpart 3 requires the Commission to participate in a disclosure regime so that the public and interested commentators can measure the performance of all of these companies, and its promotion as we've quoted in 59(4) is to develop greater understanding of the relative performance and changes in their performance over time. So again emphasis on improvement over time. Fifth, the Commission's power to set thresholds may be exercised from time-to-time, indicating Parliament's intention that the thresholds be kept under review, and sixth, 57E itself highlights the long-term benefit of consumers as the central goal. And lastly in 59.7, it's implicit in the use of the word 'promote' we would submit that it is inherently incremental and ongoing. So unlike some other statutory interventions that the Act contemplates having effect immediately, this is something by its nature which is to be achieved over time. Now can we come to the place of the thresholds within the regime? The provision for thresholds is s.57G. The first point to make Your Honours perhaps an obvious one, that it's not a thresholds regime. Thresholds do not provide for control at all and they are only one component of the regime. 57G requires the Commission to set and then permits it to periodically resets thresholds where a breach of the threshold is going to be a necessary pre-requisite to conducting a company-specific analysis as to whether control may be warranted. There is no implication in the statutory language of any presumption that breach will necessarily lead to control. If I can just digress, in the High Court effectively without argument and something originally raised by Unison was the suggestion that a breach creates some sort of onus on the company to establish why

control shouldn't follow and in our respectful submission the High Court correctly dismissed that and the statutory language is tolerably clear that there cannot be any form of onus created just because a company's breached a threshold, and if we look at ss.57H and at 57I in terms of the process for making decisions on declaration of control and the process before a declaration is made, they're in our submission entirely equivocal as to the outcome of a breach.

McGrath J It is to a presumption in the Act that the Commerce Commission will examine a party that's breached the threshold in terms of the statutory process?

Dobson Yes, there's an obligation Sir to investigate subject to the discretion to prioritise the sequence in which it's done.

McGrath J So there is a statutory obligation to investigate if a threshold has passed?

Dobson If the threshold is breached, Yes Sir there is.

McGrath J Breached, I'm sorry, yes.

Dobson And we find that in the terms of 57H Your Honour, which is mandatory the Commission must, the second point in (b) identify that breach and (c) determine whether or not to declare control.

McGrath J Thank You.

Tipping J But the decision as to whether you take control and this seemed to me to be important was governed by taking into account the purpose of this subpart – in other words you'd have to work out whether in the light of that purpose it was necessary to take control.

Dobson Yes.

Tipping J It may well not be because they may be breaching for a perfectly economically efficient reason.

Dobson Absolutely Sir, absolutely, and the debate in the lower Courts has developed this notion of false positives and false negatives, i.e. somebody may breach a threshold, a company may breach a threshold, send the signal that it's not conforming to the expected movement in prices that the Commission set by the threshold, but have a perfectly acceptable explanation for that, in which case the post-breach inquiry goes nowhere. On the other side of the coin you'll hear perhaps more from my learned friend than from me about the notion of false negatives. That is companies whose behaviour is not improving as the Commission ought to be

expecting, but are able to signal that they're staying within the thresholds. Another indication that there isn't any presumption that breach also should lead to control is s.57K, because if there is the priority exercised subject to the directions in that section, an ability for the Commission to not get around to exploring the breach say of a small company, then it can't have been Parliament's intention that there be any presumptive adverse consequence of breach. Nor can there be any sense in which control is a penalty for breach of a threshold. A decision on control has to evaluate whether the company's future conduct in light of the purpose statement warrants control, and this was aired in the High Court and there's an acknowledgement in His Honour Justice Wild's judgment at para.174 that control can't in any sense be a punishment. So what then is the relevance of 57G calling them thresholds for declaration of control? Your Honours might ask what's the implication of that qualifier on the word 'thresholds'. It might be argued that that implies that the thresholds should contain or reflect the criteria for a later control decision. However that's a variant on there being a presumption that breach should or would usually follow, or should be believed to control, and it's our submission that the preferable approach is that the thresholds can lawfully prescribe guidelines for behaviour that will not lead to control. Indeed in our submission the Court of Appeal was inclined to accept this approach when they treated the notion of breach as implying the threshold describes a standard of behaviour that has not been met. And that's paragraph

Tipping J Well if you observe the thresholds you are in what I think someone's called a safe harbour

Dobson Safe harbour, Yes Sir.

Tipping J So it has a double benefit if you like. It assures people when they are safe and it tells people when they're vulnerable.

Dobson Yes, and how the line operates is sometimes a little bit like the glass-hour full and the glass-hour half empty Sir in that if we see the thresholds as consistently pursuing the incentivising function and the screening function, then it is more appropriate to see them as screening in. What the threshold amounts to is an expectation of the rate of change and behaviour over time and if companies accept that guidance, that threshold, and stay within it then they are conforming to the expectation of the rate of change in their behaviour, and it is those which breach it that are signalling that they don't accept or that their behaviour does not reflect the extent of expectation of change in their behaviour and they are the ones because they've breached that were on to company specific inquiry. So the addition of the words for declaration of control to the label of thresholds in our submission doesn't mean that they have to have bedded in them criteria that would suggest they lead on to control. And whilst I'm dealing with the Act, could I come

back for a moment Your Honours to the information disclosure provisions under subpart 3 and Your Honours will see in s.57T that there is a separate purpose statement for this subpart about information disclosure. I would read it to Your Honours but it's instructive to take into account what Parliament wanted for this other complementary part of the regime by way of information disclosure. So it's reasonably inferred that public exposure of inefficiencies will add to the pressure for these monopolies to become more efficient, and the Commission's role in the information regime set out in ss.2, and Your Honours will see that in exercising these powers the Commission can be relatively intrusive. It's not just publication of existing information, but the Commission can require compilation of other sorts of information that the Companies wouldn't ordinarily prepare, and the publication of it. So apart from the response to the thresholds, the Commission obviously is among the recipients of all the disclosure information and in our submission provides a useful check by the Commission. The Commission is able to refine over time the information that it requires of the companies and it's an additional source of information that might signal what I've already described as false negatives. If there is a company that is for its own idiosyncratic reasons not signalling a breach but is nonetheless exhibiting behaviour which is inconsistent with the purpose statement, then the information disclosure regime is another means by which the Commission can focus on that company. Although the Commission's never had cause to do so, conceptually it's open-ended power to set thresholds, which can be exercised on a single company basis, and it's ability to do it from time-to-time gives it the power if it found from the information disclosure regime that there was a company that wasn't breaching thresholds that should, then the Commission obviously has it in its power to alter the threshold for that company. I'm bound to say that the Commission would be reluctant to do that because it sees the predictability of the price-path it sets in the threshold is actually an important part of the incentivising of the regime. So that if a company knows that if it keeps its behaviour within a certain price-path for five years, it can plan in terms of regulatory response, certainty, and it would upset that certainty if the Commission certainly altered downwards the extent of the glide-path by making a threshold that would require more dramatic in price, but it is

Blanchard J I take it from that that there would need to be a change to a threshold because if you didn't have a breach of the threshold you couldn't have control?

Dobson Absolutely, yes.

Tipping J Did I understand you to say you could have a threshold designed or directed to one or more individual companies as opposed to across the board?

Dobson You could.

Tipping J You could.

Dobson Because of the breadth Sir of

Tipping J This is 57G(1)(b)

Dobson 57G, yes.

Tipping J You would say allows that?

Dobson Yes. It hasn't been used and as I say

Tipping J On the premise that the plural includes the singular?

Dobson What I should perhaps say is the flipside of what I've just postulated which is that if there are companies that report breaches and it's clear that they've got pro-efficiency reasons for their conduct, then the Commission has it within its power to alter the threshold more leniently for that company, and predictably in the consultation with the companies, they recognise that that feature of amendment to thresholds was appropriate and it gives the Commission flexibility in setting the threshold so that if it's made a mistake of that sort so that it throws up a false positive, it can address that by amending that company's threshold.

McGrath J While you're being interrupted Mr Dobson could I just ask you to help me with the word 'glide-path'? If you could just give me a straightforward explanation of what it is. I've noticed it comes up for example in Dr Ergas's evidence.

We require you to bring your prices down by 15%. Overseas experience suggests that intervention as drastic as that is likely to have long-term unintended disincentivising effects on the investment pattern, particularly where you've got an industry like this with such long-lived assets. So the opposite of that Your Honour is a glide-path which says we would like you in five years time to have altered your behaviour within a glide-path, so

McGrath J Thank you.

Blanchard J So it's a squeeze rather than a cut?

Dobson Absolutely.

Gault J Mr Dobson, I'm just looking at 57H and I wonder if you could just help me with the practical steps in the process. We have the thresholds set and breaches reported, then the Commission determines whether or not to declare control, but before publishing an intention to make a declaration there is the further consultation under 57I, but between the report of the breach and with a view to the determination of whether or not to declare, is there an investigation or a consultation with the party affected?

Dobson Yes there is, and it's

Gault J But that would seem would be where at least initially the party affected would have the opportunity to indicate that in fact there are good reasons for the breach.

Dobson Yes, and a history of the Commission's application regime Sir includes preliminary investigations of a number of breaches that were able to be explained in respect of conduct that wasn't inconsistent with a purpose statement so it went no further. It's, with great respect to the terminology, it gives the wrong impression in my respectful submission when the step of giving notice of intention to declare control. It sounds as if it's very near the end of the process where is in fact it's only in the middle.

Gault J Well you can have a very serious effect when you start publishing notices like that on particular targets.

Dobson Yes.

Gault J And that's why I wondered whether there was an initial consultation.

Dobson There is Your Honour, and there are circumstances in which it goes no further, in which case although the fact of breach is discernible by market commentators who take a particular interest, there would be no publication of the fact if it's accepted that the breach for entirely innocuous reasons.

Gault J Thank you.

Dobson If Your Honour wants any further detail, the Commission actually issued some assessment and inquiry guidelines and they're in the volumes, but I don't apprehend it's necessary to take Your Honour to it.

McGrath J But then you say Mr Dobson that there is a statutory duty to consult between step B and step C, or is an administrative practice?

Dobson Administratively the process of determining whether or not to declare all or any of the good or services supplied to be controlled can't simply be done as a knee-jerk reaction as a result of the breach, so there is a process

of determination which involves consultation with the company, ascertaining what the circumstances of the breach are.

McGrath J But is that as a matter of administrative practice by the Commission? There's no specific statutory direction to do that?

Dobson Nothing more than we find in 57H.

McGrath J Nothing more that is in 57H?

Dobson No.

Anderson J But it would be inefficient not to because of the cost factor involved in the 57I process.

Dobson Yes, and as with everything under this regime, the Commission actually consulted about the process it would follow and had industry support for the regime generally in that.

Anderson J It's worth noting that the 57I process reaches far beyond the LELB itself.

Dobson Yes.

Anderson J It's any interested party.

Dobson Yes. If I could just finish the point about the prospect of the thresholds being amended in favour of one company if it was a false positive. I am going to ask Your Honours on a number of occasions to go to the affidavit of Calum Gunn, which is at volume 2 of the case on appeal at tab 14. Now I'll say a little bit more about the affidavit generally the next time we go to it, but just on this point if I could take Your Honours to para.99, in early 2003 the initial proposals for the design of thresholds were consulted on and Your Honours will see back at para.98 that Price Waterhouse Coopers was instructed on behalf of some 18 of these lines businesses and it made submissions. Unison in those days as Hawke's Bay Network made its own submissions and cross-submissions and I just wanted to draw Your Honours' attention to its own recognition set out in para.99 about the role of a price-path threshold. Your Honours will see that they submitted to the Commission that 'the price-path that we set out is only a trigger for closer scrutiny by the Commission of particular businesses, rather than a binding constraint on those businesses. Businesses that feel they should breach the path for reasons related to efficiency will remain able to do so', and that was their stance at the time the form of the initial thresholds were being designed. Now Your Honours have asked me about the process under s.57H. It might be useful with respect if I just spend a little longer on what happens after a breach occurs. Unison argued in the High Court that the

focus of a post-breach inquiry had to be entirely historical. It had to look back at how serious the breach was, effectively looking at a freeze-frame in time at the circumstances that had caused the breach at the time it was reported. In our respectful submission the High Court correctly rejected that and accepted the Commission's interpretation of its requirement which was that once a breach has been signalled and we get into the post-breach stage, to meet the purpose statement by definition it has to be a prospective inquiry because we are looking at the issue of whether there is justification for control for the long-term benefit of consumers. So whilst a company may have breached, and the circumstances of that breach will have some relevance, a decision on whether to control must be a forward-looking one. So we have in a sense a trigger by the breach of threshold but then the steps after that are forward-looking. The Court recognised, the High Court recognised here that there is a dove-tailing with how control decisions under part 5 of the Act, which we haven't yet come to at all, are made, and if I could just draw Your Honours' attention to the provision in s.57M which is itself within part 4A but anticipates how the Commission's work will be done if we get into a control situation, and Your Honours will see in 57M, which is itself within part 4A but anticipates how the Commission's work will be done if we get into a control situation, and Your Honours will see in 57M that 'in exercising its powers under ss.70 to 72, those of the imposition of control which are available generally is to be controlled under part 4 as well. Concerning goods and services supplied by LELB, the Commission must have regard only to the purpose of this subpart and not the matter states in 70A'. So what Parliament did when introducing part 4A, is that it adopted in other respects the control mechanism that was already there for controlling goods and services which is the application of the control powers, if for example there's a decision made that control of something other than an electricity business is warranted under part 4. But it said when exercising that power, don't do it in accordance with the purpose section in 70A but come back to the purpose of this subpart. So that means that the purpose statement requires consideration of future conduct and extent of changes over time.

Tipping J Well you can't influence past conduct because it's already happened.

Dobson No, absolutely not, and it would be futile because it may be what we've called the false positive if you identify simply the extent of the breach and say that is a justification for control, it's ignoring the impact it's going to have in the future and it's irrelevant to future conduct, so it must be forward-looking. Now coming more specifically to the requirements for thresholds, 57G, the only statutory guidance given in the Act as to the content is that they may be expressed in either quantitative or qualitative terms with the rider, as I've already pointed out, that the first set of thresholds must be set as soon as practicable after the commencement of the Act. It's common ground between Unison and the Commission that

the thresholds should incentivise behaviour towards more efficient operation of the relevant markets, again for the long-term benefit of consumers, and in doing that deliver the attributes in (a) to (c) of 57E. It's also common ground that to some extent at least the thresholds should screen, ideally to identify those companies whose conduct is progressing satisfactorily towards efficient operation, and also to identify companies whose behaviour warrants closer consideration because they're not conforming to those expectations. And if the screening and incentivising functions are seen as working together, then it inclines to a view that what you are doing is by the thresholds screening in those companies whose behaviour is conforming with the expectation of improved efficiency over time, and it incentivises them because that means that they've positively responded to the signal the threshold sends them and they've been prepared to be corralled into a form of pricing behaviour that will lead them to more efficient

Tipping J Is this proposition that the Commission sees as of approximately equal importance the ideas of incentivising in and screening presumptively out if you like?

Dobson Yes.

Tipping J But you don't sort of give great priority to one or the other were it intended to work together?

Dobson That's the submission of the Commission Sir, that it's impossible to take from anything in either the statute or its surrounding circumstances that would suggest a prioritisation be given to one over the other. Having said that, the tenor of the Court of Appeal decision tended to down-play the incentivising function but the Commission would respond to that by saying it's obviously vitally important to a targeted control regime where a significant element of the increased efficiency is procuring a change in behaviour without the cost of control. You are hoping to influence behaviour with the least possible regulatory intervention, and it's

Anderson J The incentive is to avoid eligibility for inquiry and potential control?

Dobson Yes.

Anderson J But you could have a threshold that didn't have much emphasis on incentive so long as it wasn't a disincentive.

Dobson Ah

Anderson J It could be neutral in terms of incentive and yet be a necessary step in the process of inquiry.

Dobson I apprehend the Commission would say that to optimise the attainment of the statutory purpose it ought to incentivise and in many respects incentivise more than send the negative signal

Anderson J If it can.

Dobson If it can. The incentivising aspect, just in terms of Your Honour Justice Tipping inquiry about prioritisation – priority between the two – one thing in favour of incentivising is that it's explicit that it's to be incentivised and that is in contrast to part 4 control where there's no element of an explicit recognition of an attempt by the Commission to, or a responsibility for the Commission to incentive greater efficiency and behaviour.

Tipping J Well in the sense, borrowing my brother Blanchard's metaphor, the incentivising is a squeeze. It's not the cut that controls

Dobson Yes His Honour might progress it by saying that it only becomes a squeeze if you feel you have to go outside the glide-path, the corralling that the

Tipping J Yes true, true.

Blanchard J I think we could have some danger of drowning in metaphors. I don't myself find the idea of screening in or screening out very helpful, it's just confusing. As a metaphor, I understand what you're saying.

Dobson Okay. One point that the Commission doesn't accept in Unison's submissions is that the thresholds should focus and confine the exercise of power to declare control if what Unison means by this submission, is it threshold should in someway fetter what the Commission does after a breach is identified, then the Commission parts company from Unison on that point. It's not necessary in our submission that the design of the threshold should reflect any expectation of the Commission's response to a breach because there are likely to be so many inconsistent reasons for the breach. There's also no basis for inferring as Unison does that the part 4A thresholds are intended to be set on profit levels, assessed by reference to updated asset values, that's a point made in the Unison submissions at para.5.12. And the Commission would say that to the contrary reflecting the prospect that thresholds might address the extent of change in prices, it is the amendment that was made to part 5 in the same year, in 2001, to mandate control of companies by reference to CPI-X forms of control. Now if we go to part 5, Your Honours won't see the reference to CPI-X, but the Parliamentary explanation on the introduction of that amendment made it clear that the change to terms of ss.70 to 74 which deal with the means by which control of goods or services can be imposed was intended to broaden the armoury available to include a CPI-X form of control, and

clearly the range of thresholds that might logically screen for possible control, which might be on a CPI-X control basis, ought logically to include a preliminary proxy of some sort, using the same

Tipping J Is there any evidence against you that CPI-X per se is an inapt method of control in present circumstances? Any evidence against you?

Dobson No there is no evidence. Your Honour's question was whether it's ineffective as a method of control. I am setting the context

Tipping J Sorry, ineffective for its s.57E purpose I should have said.

Dobson As a threshold.

Tipping J I'm sorry, I didn't mean to say control, I meant as a threshold. I mean is there any economic evidence saying this CPI-X per se is just out of the ballpark as far as a threshold is concerned?

Dobson I don't understand there to be any that says that but the qualification to that Sir is that there are in effect three moving parts. I wanted to come on and describe how CPI-X works, but

Tipping J Yes, well I know what you mean by that.

Dobson Just briefly there is the starting price at the beginning of the period in which you are requiring response to the threshold. There is the extent of the X factor which is an expectation of increases in efficiency and is the period over which the threshold is set. Now CPI-X as a threshold was supported unanimously at the initial threshold stage. All of the people who responded said yes CPI-X is appropriate. Unison, for its part, recanted from that at the point in time where the Commission consulted on the revision of the form of the threshold.

Tipping J Well they may have recanted, but is there any evidence before the Court from a person qualified to give such evidence that CPI-X per se is wholly inapt for a s.57E exercise?

Dobson No, the only economic evidence is that of Mr Sundakov. His evidence is that he would have designed the thresholds differently. He would have required a starting price adjustment, what's called a PO adjustment.

Tipping J So he argues about the individual integers, but he doesn't argue about the methodology as such?

Dobson I don't understand his evidence to say that Sir, no and I

Tipping J Well that was my impression of it, but no doubt we'll hear if

Dobson Yes.

Blanchard J A little while ago I thought you said, I was struggling to keep up at that stage, that ss.70 etc had be altered and that one of the purposes of doing that was to enable the use of CPI-X. Did I misunderstand that?

Dobson No, that's correct Sir.

Blanchard J Well have you got a reference to the Parliamentary materials?

Dobson I can read to you Sir and we can produce it after the adjournment the source, the Parliamentary materials acknowledging that CPI-X was in mind

Blanchard J Because that does seem to me to be of some significance.

Dobson Would Your Honour prefer me to come back to that when I've got the source rather than the quote from it, or would you like me to deal with it now?

Blanchard J No, not if it's going to take up time to try to deal with it now. It may be quicker to come back to it.

Dobson I'll do it that way, thank you Sir.

McGrath J Mr Dobson perhaps while you're interrupted, I'm just pondering your statement there's no basis for say profitability has to be part of a threshold. Did I understand you correctly to make that observation?

Dobson Well it's really in response Sir to my learned friend's submissions at para.5.12 of the Unison submissions

McGrath J I'd just like some elaboration, because obviously in one sense profitability is going to be relevant to the (a), (b) and (c) factors of 57E.

Dobson Yes.

McGrath J I'm just interested to know what it seemed to me to be quite a profound statement if you should be asked to elaborate on it.

Dobson Thank you. Para.5.12 of my learned friend's submissions says 'reading part 4A as a whole, it's difficult to escape the conclusion that the legislation anticipated that thresholds would be set based on profit levels, assessed by reference to the recalibrated asset values'.

McGrath J Yes.

Dobson And the Commission's response is to say no, you can't read that Parliamentary expectation into part 4A. There are other means by which thresholds can be set other than on profit levels. I'll come on to explain in just a moment Sir why

McGrath J Are you really saying that eventually you will get to that, the need to look at profitability in relation to re-valued assets or updated valued assets, but a threshold, particularly an initial threshold, doesn't have to get into that.

Dobson It doesn't have to Sir and the point about it is that even as a form of control, control need not be of the level of profit, and I'll come and explain why that the form of regulation of such monopolies in Australia and UK has preferred a cap on prices rather than a cap on the level of profit that a monopoly can earn, and so the Commission

McGrath J That was the old system I take it that wanted to keep it at profit control?

Dobson Yes, yes. Now perhaps it's convenient to put my toe very gingerly into the economic pool. An awful lot of intellectual horsepower was exerted on the consultation on the form of thresholds, all before I came along obviously, and there is a great deal of analysis that's been undertaken. Simplifying it as best as I can the classic rate of return regulation that Your Honour Justice McGrath has just been asking me about worked by seeking to limit the level of profits so that in crude terms the regulator would say well we think this is your weighted average cost of capital, you shouldn't be earning than that and we'll therefore put a cap on the return of the investment you have in the business. Experience suggests that that risks monopolies gold-plating their assets as the economists call it, i.e. they invest more in an inefficient way because it is the value of the assets that determines how much return they can make, and that's rather out of favour with the economists and the recent regulation has been of a price cap control, that is that an expectation of efficient prices is determined and over a period of time the regulated business will be constrained to a certain level of rate of change in the average prices it can charge. Now that is seen by the economists as incentivising because if you put a cap on the prices, but allow the rate of return relative to those prices to determine itself, then you incentivise the business to make more efficient use of its assets, and this form of control is invoked by the notion of CPI-X. Obvious CPI being the rate of movement in inflation, minus X representing an expectation of the extent of efficiencies that either the business or the industry can reasonably be expected to make. And Your Honours suggested to me near the outset that those three things in (a) to (c) of 57E are really what would happen in a competitive market, and in a

workably competitive market, fairly basic, all firms face pressures on their costs from inflation and maybe other pressures and with competitive pressures on prices to succeed, firms in the competitive market strive to be more efficient so that they can retain more, of prices that are pegged, not by a regulator but by the effect of their competition. And the drive for efficiency will see prices go up generally at less than the rate of inflation and the difference reflecting the increased efficiency that the firms are able to make. So if we went back to 57E, and I don't think it's necessary to do so, and ticked off the (a), (b) and (c), we would see that in a competitive market the competitive forces deliver the (a), (b) and (c). In contrast monopolies can allow their cost to rise; they can be slow to innovate and in particular they can raise their prices without any competitive constraint, and a monopoly's ability to increase prices without any competitive constraint is one of the most fundamental forms of use for monopoly power. So the Commission treats its task under part 4A as intended to mimic what happens in competitive markets, and that was set out as a proposition for guiding the form of thresholds that were designed from its first discussion paper. I can take Your Honours to it if you're interested but I don't apprehend it's necessary to do so.

Gault J Mr Dobson I can see the reasoning outlined in this approach, but trying to relate it to 57E, where you get the artificiality of price control as against a competitive market, how do you promote the sharing of the benefits of efficiency to the customers?

Dobson Over the long-term it's intended that if their prices are constrained in a way that they wouldn't be but for a threshold or control, then over time the prices charged to the consumers will be lower than they would otherwise be, and that represents a sharing of the benefits with the consumers. That's a superficial answer but is there something more behind Your Honour's question?

Gault J Well by sharing the benefits of efficiency gains, I suppose if you don't let anyone increase their price, naturally there's a consequential benefit to consumers is that what you're saying?

Dobson Yes, they get the benefit of the lower prices.

Anderson J And also get the benefit of greater efficiencies in order to reduce profits against a fixed price?

Dobson Yes.

McGrath J Are you saying that's what Parliament had in mind with para.(c) in respect of an incentive not to increase prices at all, or are you saying that if in the long-term you achieve that benefit once you get to your second threshold?

Dobson In the long-term, and there is no fixed mind Your Honour with the Commission that price increases are necessarily bad because there will be situations in which it is pro-efficient to permit a company to increase its prices, so there isn't any closed mind about that and I'm sorry if I've given that impression. 57E(c) respectfully I submit has to be read as including through lower prices than they would otherwise be but for this regime, so it's

Tipping J It's got quantitative aspect and presumably a qualitative aspect to it.

Dobson Well again we come back to your original question Sir about prioritising among them because it has to be balanced doesn't it with provision of services or a quality that the consumers want, and if in a particular area they will want absolute assurance that there will never be an outage, then the consumers must pay for that and the prices would reflect it, but

Tipping J All I'm say is little c presumably has in mind by the use of the word 'including' that it can be through lower prices but it can also be through other means.

Dobson Yes, as His Honour Justice Anderson was saying, improving quality relative to the price that's charged. Now still dealing with the way CPI-X works in a controlled situation, CPI-X puts the squeeze on prices incentivising firms to be as efficient as possible because they can retain part of the benefit for a period, so the appropriate X factor needs to periodically be re-assessed once one can assume that the incentivising effect to a more efficient level has continued for a period relative to one set of thresholds, then take stock and set another set that may recognise that there are far fewer efficiencies to be made in a following period, and you'd reset the X factor in that way. But there are two trade-offs which are relevant to the long-term nature. The first is obviously the rate of the X factor, the more generically it is set. In other words if you just had one X factor for all companies, then the more incentive there is for individual companies to say gosh we think we can beat the average, and you therefore increase the incentive effect, the more generic the X factor is set. There is a similar trade-off in the period of time. If you set a threshold just for a couple of years and the companies know that they will reap the benefits of efficiencies better than the average expected for just that period, but they might then lose them, then they'll be less incentivised, whereas if you set it say for ten years they would know that if they set out on a path of improved efficiency, then they'll be retaining part of the benefit for the rest of the period until the thing is re-set, so there are lots of fine-tuning in terms of the incentive aspect

Tipping J Well the moving parts are inter-connected. You've got to see them as a whole, you can't just fiddle with one.

Dobson Yes, so I hope I'm beginning to set the scene in which the Commission debated alternatives but came to a combination CPI-X as a threshold, bearing in mind it's a discrete task from control, so long as it was complimented by some constraint on quality, because of course if the monopoly can't put its prices up but is unconstrained as to quality then it may just simply reduce the number of staff it has and therefore reduce the quality of its services to make the revenue go further. So it's our submission that when contemplating thresholds rather than control itself, one logical option was to consider some form of CPI-X design that is consistent with a form of constraint that might apply if control is required, and I've endeavoured to describe to Your Honours what the incentivising effects of that are and it does also screen and I'll come on to describe the screening aspects in a little more detail specific to the thresholds themselves. That gets me on my checklist to item 5 – the relevant legal test for substantive unlawfulness. This challenge by Unison is founded on the proposition that the Commission failed to promote the statutory purpose in deciding to design the price bar thresholds as it did. I apprehend that the legal test is uncontroversial and I'm happy to just summarise it briefly by reliance on the authority that my learned friend also cites and start with *Padfied*. If I could just take Your Honours briefly to that decision. If Your Honours have the Unison Authorities, volume 2, if we're all given the same cover, it's got a blue cover may it please Your Honours, at tab 21. Your Honours are probably familiar with the circumstances in *Padfield* which involved a decision about the conduct of an inquiry in relation to milk businesses and the passage I wish to draw attention to relative to the test here is in the speech of Lord Reid at page 1030, because the issue in the case was whether if the Minister had a discretion was simply unfettered and he could do what he liked, and in the context of acknowledging that there must have been some fetter on the discretion which the Court could review, picking up the report half-way between lines B and C His Lordship said 'Parliament must have conferred the discretion with the intention that it should be used to promote the policy and objects of the Act. The policy and objects of the Act must be determined by construing the Act as a whole and construction is always a matter of law for the Court. In a matter of this kind it is not possible to draw a hard and fast line, but if the Minister by reason of his having misconstrued the Act or for any other reason so uses his discretion as to thwart or run counter to the policy and objects of the Act then our law would be very defective if persons aggrieved were not entitled to the protection of the Court'. And over the page at the very bottom of 1032 His Lordship continued, just one line up from the bottom 'but I do not agree that a decision cannot be question if no reasons are given'. That's the particular circumstances there. 'If it is the Minister's duty not to act so as

to frustrate the policy and objects of the Act, and if it were to appear from all the circumstances of the case that that has been the effect of the Minister's refusal, then it appears to me that the Court must be entitled to act'. And at the foot of that page after referring to *Julius and the Bishop of Oxford,* three lines up from the letter G, 'I have found no authority to support the unreasonable proposition that it must be all or nothing. Either no discretion at all or an unfettered discretion. Here the words "if the Minister in any case so direct" are sufficient to show that he has some discretion but they give no guide as to its nature or extent. That must be inferred from a construction of the Act read as a whole, and for the reasons I have given I would infer that the discretion is not unlimited and that it has been used by the Minister in a manner which is not in accord with the intention with the statute which conferred it'.

Tipping J Would you accept the proposition along these lines that your opponent must show that these thresholds could not reasonably be seen as promoting the purpose and policy of the Act?

Dobson Yes. My learned friend will I apprehend add to that a criticism that he treats the Commission as having asked itself the wrong question.

Tipping J Well if it does so then presumably it may have that consequence.

Dobson Well yes though the reason I introduced that as a criticism as having asked itself the wrong question Sir can only be addressed after one determines what is the purpose of the Act and has it been addressed, and it may be a manifestation

Tipping J Quite.

Dobson Of misconstruction of what the purpose of the Act was if the Commission then asked itself the wrong question, but in my respectful submission, that separate concern he has rather gets subsumed because if we start with a question 'has the Commission formulated a threshold that can't reasonably been seen as promoting the purpose of the Act, and

Tipping J Well you've got to decide what the purpose of the Act is before you can answer the headline question clearly. But you would be content with the formulation along those lines with that rider that you have to be clear as to what the purpose is first?

Dobson Yes. Now my learned friend also makes the point with which we don't disagree that there is overlap in judicial review that certain grounds recognised for challenge, particularly when it comes to the substantive lawfulness of statutory action overlap on substantive unlawfulness rather than process errors. There are classic New Zealand decisions that frame

the Court's approach. I could just take Your Honours briefly to 2, *Bulk Users and CREEDNZ. Bulk Users* Your Honours we'll find in tab 7 of my learned friend's authorities, that's in the green volume, tab 7 may it please Your Honours. Some of Your Honours may remember the factual situation of this case

Tipping J I see my brother McGrath may have some cause to remember this case.

McGrath J Another loss.

Dobson Not that fact but it was a slightly different context gave me some pause for

Tipping J I thought that was your main point.

Dobson Troubling Your Honours with it, but it is in my respectful submission apposite and just to take Your Honours to a page at 136. There was an argument about whether there was an effective provision and if I could just draw Your Honours' attention in the decision of Justice Cooke, as he then was. Starting at line 20 there's a passage 'no doubt too there are cases in which an error of law by an administrative tribunal is not significant enough in the context of the tribunal's reasoning as a whole to lead a reviewing Court to intervene'. He then goes on some lines later 'in general remedies in this field are discretionary'. Coming down to the next paragraph 'the principle that the Courts of general jurisdiction have ultimately the function of interpreting the Act of Parliament will prevail only in so far as the material expression used in the Act in question – here "direct interest in the matter" – is to be interpreted as posing an ascertainable test. To the extent that there remains legitimate room for judgment in applying the test, the Secretary's opinion is make the statutory criteria. If he addresses himself to the correct test and the relevant facts (see *Daganayasi*), his decision will stand unless it can be put in the extreme category of a decision at which no reasonable authority in his position could have arrived. By the use of the words "in his opinion" the legislature has indicated that there may be a grey area where there is truly room for discretion as to whether or not the direct interest test is satisfied'. And of course we say here that whilst there isn't anything explicitly vesting an opinion in the Commission, for reasons I have sketched at the beginning, there is a wide discretion left to it, so we're in the same territory. The judgment records submission from Mr White who was there for the *Natural Gas Corporation*, then at line 47, 'in the end however he accepted that if contrary to his submission a pure question of statutory interpretation arose as to the meaning of "direct interest in the matter", the Secretary's opinion on it would not be conclusive. In other words the Secretary must apply the right test'. So it is for Your Honours to interpret the purpose statement and the other provisions about thresholds, but once

the Commission establishes that it correctly interpreted the Act, the way it applied it is within its discretion. If I could take

Tipping J Is there any specific argument against you that you've misconstrued your statutory power?

Dobson Yes, as I understand Unison's argument Sir it is the effect that there was an obligation to design a threshold which would screen and screen to identify companies that are eligible for control. So when we get into the detail of the argument about what the threshold did and what its deficiencies are, the difference is perhaps to find this way the Commission says it should signal those companies that aren't conforming with the incentivised path and it identifies them because they've breached that threshold and that justifies a further look. The threshold is designed so that they are more or less likely, or more likely than not, to have breached because of a reason that justifies further investigation, but the threshold does not need to be definitive about that. The threshold will accommodate false positives and false negatives. Unison says it's got to go further and I'll return if I may Sir to the detail of that.

Tipping J Thank you, yes of course, thank you, but that is the key respect in which you're said to have erred in law in misinterpreting your power in the sense of the parameters of the threshold. They say the threshold must be more specific

Dobson Yes, yes Sir

Tipping J Than you putting it very very simply?

Dobson Yes, yes Sir.

Tipping J Yes.

Dobson The only other authority on the test for the Court in substantive unlawfulness I wish briefly to take Your Honours to is *CREEDNZ* which is two tabs on in that same volume, tab 9. If I go immediately to page 183, line 7, again it's the judgment of Justice Cooke as he then was, 'what has to be emphasised is that it is only when the statute expressly or impliedly identifies considerations required to be taken into account by the authority as a matter of legal obligation that the Court holds a decision invalid on the ground now invoked. It is not enough that a consideration is one that may properly be taken into account, nor even if it one which many people, including the Court itself, would have taken into account if they had to make the decision'. So that's a limit. The Court on substantive unlawfulness intervenes where there is an absolute obligation it's been ignored. Your Honours might treat that as a variant on the recognition that

the weights to be given to various factors is for the decision-maker, not the Court.

Tipping J Well it's sometimes but if they've got a discretion to take into account they've also got a discretion not to take it into account.

Dobson Yes.

Tipping J That's the mandatory concept.

Dobson Yes, I would adopt that as appropriate here Sir, yes. I just draw Your Honours' attention to one last passage at the foot of that page, about line 53, talking about the standard of proof a civil one of the balance of probabilities. His Honour observed 'quite slight evidence may be enough to discharge the burden when the allegation is that a certain matter has been taken into account. It is less easy to discharge the burden of proving a negative – that something has not been taken into account'. And that Your Honours may think is only

McGrath J Sorry, where's that point again Mr Dobson?

Dobson It's at the very bottom of page 183 Your Honour; about line 53, carrying on to the first two lines on 183, thank you.

McGrath J Yes, got it thank you. Have you finished with *CREEDNZ*?

Dobson Yes I have.

McGrath J Can I just ask you this? To go back to Lord Reid in *Padfield*, he speaks of looking at the scope of a power, and it seems to me that the key issue is how wide the power of the Commission was in this case, but he speaks of the need to infer that from a construction of the Act as a whole. I'd be interested to know how that would relate to the modern form of drafting New Zealand statutes at least, where we have a specific purpose clause. Do we focus on that or would you say that we go beyond that and look at the context and general scheme of the part of the Act that we're dealing with as well?

Dobson In terms of the specific issue before Your Honours, it's my submission that the essence of the lawfulness of what the Commission has done is to be measured by reference to part 4A. I've got to qualify that Sir because I've drawn in one sense a contrast with the provisions of part 4A and I've also invited Your Honours to go forward to part 5, but because the scheme of the Act introduces a specific purpose statement, in my submission that's quite important in interpretative terms, putting a fence around part 4A and we would have to find some justification if there is something that is

naturally consistent with but not dealt with in part 4 to resort to something outside it.

McGrath J But you're saying we look at in particular the whole of part 4A of which the purpose section is one provision only?

Dobson Yes.

McGrath J Yes.

Blanchard J Would that be a convenient moment?

Dobson Yes, may it please Your Honours.

Blanchard J 15 minutes.

11.31am Court Adjourned
11.48am Court Resumed

Dobson Thank you Your Honours. There are two issues arising from questions in the earlier session. The first Your Honour Justice Blanchard wanted the source of references to the CPI-X as Parliament's intention in the amendment to part 5. I've got two pieces of paper but there is a third and we haven't been able to find it in the adjournment, so if Your Honour will give me till after lunch, we'll give it to you all as a package. The second question Your Honour Justice Gault asked was whether the inquiry actually identified any companies that were of significant concern. It's fair to say in summary that the report is equivocal on that. It isn't in the materials but I could just read you the one paragraph that most directly addresses it. It's at para.75 of the report of the Ministerial Enquiry into Electricity. It read 'on its face table 3 shows significant variability of returns between companies. A number of distribution companies appear to have been earning high ROI – return on investment. Further analysis shows that some of the apparently high ROI's are a consequence of the methodology set by the regulations which treats revaluations as a component of the return on investment in the year of revaluation. Accordingly published ROI's do not provide helpful information about underlying profitability. As well as undermining the value of this information this also illustrates the lack of reliable and consistent information by which customers can judge distribution performance'.

McGrath J Thank you.

Dobson Now if it pleases Your Honours can I move to the sixth of the points on the sheet I gave to Your Honours at the beginning, namely the lawfulness of the IPPT. Just to put it in context, perhaps repeating my dialogue with Your Honour Justice Tipping, the major difference between the Commission and Unison on what's required of a threshold is the extent to which to which it should screen, bearing in mind that screening is not an explicit notion in the Act

Tipping J Extent and precision presumably of screening?

Dobson Yes, extend and precision, yes. The Commission requires a breach to signal some behaviour that is likely to be inconsistent with the purpose statement and inconsistent with (a) to (c) of 57E to the extent that warrants a further look and possibly an in-depth analysis by way of a post-breach inquiry. Unison argues for something far more prescriptive in the sense that on Unison's view thresholds must be designed so that breach signals are justification for control, so that if the company breaches then it is at least prima facie eligible for control, and the only question it seems to the Commission if the thresholds did so much of the work as that is why not control, so it would be a threshold that created a presumption of adverse consequence for the company if it's to identify companies that are eligible for control. Predictably Your Honours the Commission says that Unison's contention places far too much emphasis on screening as de facto, an instrument of control, and it's our submission that the purpose of the thresholds' component of the overall regime does not require that to be achieved on its own.

Tipping J Too much emphasis on screening as opposed to incentivising, is that what you mean?

Dobson Expecting it to screen too much Sir, yes, to put it crudely. The economic evidence on which Unison's claim is based is from Mr Sundakov. It makes it clear that thresholds which will achieve Unison's version of the screening function would have to be designed individually for each company; reflect a detailed investigation of its business and on Mr Sundakov's view start with a "Po"adjustment, that is at the beginning of the regulatory period, undertake a sufficient individual inquiry to say do we want an adjustment to your prices before we begin applying the threshold, and if I could just take Your Honours to the evidence of Mr Sundakov. It's in volume, the pink one, under tab 12. Well perhaps I should first make a preliminary observation with respect to the witness. If Your Honours go to para.4 on page 172 on the case on appeal Mr Sundakov describes the request of him in terms as 'to provide expert advice on the economic aspect of the targeted price control process under which the Commission sets thresholds', and here he puts his own gloss on what's required of them, 'to assess, identify and determine whether to

declare goods or services to be controlled' and it's a predictable caveat from the Commission's perspective on this evidence that from the Commission's view of what thresholds should do, he's actually the wrong question. He's asking whether they are thresholds that will assess, identify and determine; i.e. on Mr Sundakov's view the thresholds do the whole job. In light of that observation about it, if Your Honours would turn to para.20 at the top of page 178 of the case, Your Honours will see Sundakov's opinion that an appropriate price threshold would satisfy three criteria. It would recognise that price changes need to be interpreted by reference to the level of prices and returns at the start of the regulatory assessment period. So that's suggesting a company-specific analysis of the level of prices at the outset, inferentially likely to lead to a PO adjustment but not necessarily. It would take in account of each distribution company's pattern of investment, so that would require some measure of the individual needs for new investment of each of the 29 businesses, and it would make adjustments for changes in the quality of service to ensure that by comparing prices at the beginning and the end of the regulatory period, we are indeed comparing like with like. Now that throws up a number of things; one of which is the quality threshold. We don't need to trouble too much about, but again is company specific. So Unison's case is based on this analysis which imputes a requirement that the thresholds will be company specific and if taking Mr Sundakov on the scope of the work necessarily undertaken to meet those elements in para.20, a very substantial level of research intended to be reflected in the threshold.

Tipping J Is his primary reason, if not his only reason, why your thresholds are no good that they're not company specific?

Dobson Ah, I think that's an over-simplification with respect to the witness Sir. He does go on and say for instance in para.22

Tipping J But it's a material ingredient of his reasoning is it that these thresholds are not company specific?

Dobson Well that must fall out of this, yes.

Tipping J Yes.

Dobson He says in 22, last sentence, 'while it may not be possible to design a perfect threshold, relatively simple modifications would have resulted in a threshold which was less prone to the two types of error identified above, i.e, false positives and false negatives'.

Blanchard J Well that's no doubt quite correct if you have the time to do it.

Dobson And if you place a weighting Your Honour on the extent of signals you want out of the thresholds, which of course has a balancing exercise because the more you put into the thresholds and the more you require of the companies, the more you're front-ending the work that might only be needed in respect of a small number of them, so

Tipping J The whole concept of false negatives and positives is linked isn't it to this company-specific point because the elimination of those problems as he sees them must presumably involve some greater specificity as to individual companies in order to eliminate the ones that wrongly get looked at and the ones that wrongly don't get looked at?

Dobson Yes, well I'm not competent Sir to deal with the proposition in absolute terms as to whether an individualised threshold could ever eliminate a false negative or false positive, but

Tipping J No, no, I understand, but the

Dobson But on a trend

Tipping J But it must, it must be a plea for greater specificity.

Dobson Yes it is.

Anderson J An essential indicator that legality depended on whether it's a Lexus or a Bentley, where all you really need is a car.

Dobson Well that's the Commission's point as I'll come on to in a moment Your Honours. Whilst I've troubled you to take up that volume, could I invite Your Honours to go to tab 14, which is the Gunn affidavit for the Commission? That affidavit, and it's not a short one, was intended to do two things. First it was a chronological record of all of the Commission's consultation and its consideration, it's dealings with the companies and that's the major explanation for its length. It was also prepared by Dr Gunn as a response to the Sundakov criticisms because as the case was mounted by Unison, it was on the basis of the Sundakov wish-list of what thresholds ought to contain, so it is necessary for me to come back to it because it's quite a convenient compilation of what various relevant parties have said about the topics I need to deal with on the content of the threshold. But Your Honours will see in para.9 he summarises as an economist the effect he attributes to Mr Sundakov's criticisms, and then he deposes in para.10 that all these proposals were addressed and debated extensively in the Commission's process for setting thresholds, and he sets out the rest of his affidavit in which he's addressed each of these elements raised by Mr Sundakov's evidence in the rest of the affidavit.

Tipping J Does he say anything directly on this question of specificity or individual company orientation that one seems to be able to imply from Mr Sundakov's evidence?

Dobson He says a good deal about it Sir, yes

Tipping J Well we may have to go and read it all but I just wondered if there was any key points in his evidence that

Dobson On the Commission's view, on the level of specificity required?

Tipping J Yes, why they didn't think it was appropriate at this stage or whatever their view was on this specificity question.

Dobson I think it's pervasive Sir, but if I could just check with my juniors to where there is one or two we could put to you. Alas the answer is not to a single paragraph Sir, because I think probably that extent of specificity is raised by the comments on the profit threshold by the adjustment for the pattern of investment, because obviously that is something which if it has to be company specific isn't addressed in the thresholds and also the PO adjustment.

Blanchard J Sorry, there's an interesting quotation from Professor Ergas at para.97.

Dobson I was going to come to that Sir, yes, thank you. That's Unison's former view of course

Blanchard J I appreciate that, but it's quite interesting.

Dobson Yes, and one of the short points I made at the outset Your Honour is that there was very widespread support for the way the Commission was working, including at the initial stage from Unison, although this is in the period of cross-submissions following the March 2003 conference, so it's when the initial thresholds rather than the revived thresholds were being debated by the Commission.

Blanchard J Yes, no I understood that, but we're primarily focused on the initial thresholds at the moment.

Dobson We are, yes.

McGrath J Mr Dobson, just going back to para.10, when Dr Gunn refers to proposals being addressed, do I take it that these are the Commission's own proposals rather than the proposals of Unison or any other party?

Dobson Yes the

McGrath J That's referring that to para.9?

Dobson Yes, but what Dr Gunn is doing is saying Mr Sundakov criticises the thresholds on these grounds and in the course of describing everything the Commission has done, I will address each of them in these paragraphs, so that's the design of what turned out to not be a short affidavit Sir.

McGrath J Yes.

Dobson Now Your Honour's comments have perhaps already anticipated the next point I wish to make which is that given that the Commission has a discretion, we introduce a continuum I would suggest reflecting the range of possible attributes that any given threshold might reflect, and at one end, or the Commission would say possibly even over the outside boundary of one end, you will have a very company specific advanced indication of whether controls should be imposed once a threshold is breached and that must be at the very least at the most complex end. Somewhere towards the other end of that continuum you will have a simpler essentially industry-wide design that flags a material element of the line's businesses behaviour that would be most likely to reveal conduct inconsistent with the purpose statement, and if it has that attribute one would hope that it's also most likely to exclude companies that are on a path towards efficient operation. And in that description I am intending to encapsulate what the Commission saw as the requirement for a threshold, and the very basic administrative law point is that so long as the Commission's threshold came somewhere on that continuum then it's within the statutory purpose. I can't be seen as frustrating it and the particular design dictating where it would sit on the continuum is a matter within its discretion, and there's no question that it hasn't discharged the discretion with the benefit of extensive expert advice, both internal and consultants its retained and consultation with all the interested parties.

Tipping J I know this is a dangerous expression in this and other fields but what you're arguing for is a very wide margin of appreciation on your client's part Mr Dobson isn't it?

Dobson I am, and the Court of Appeal used just that phrase Sir in crediting the Commission with a wide margin of appreciation, but then nonetheless finding that the initial wasn't meeting the purpose in some way sufficiently.

Blanchard J It's a long continuum. You don't fall off the edges of it without going a fair way.

Dobson Well figures of speech can be difficult Sir but there are numerous shades of difference between something that will incentivise and will screen the 28 businesses. The initial threshold doesn't discriminate between any of them so the X factor is common to all of them. If we move a distance along the continuum we get to the revised threshold which does set four bands within the X factor, and I need to come and I'm sorry, I'm anticipating an explanation I perhaps need to give first, but just to deal with the continuum analogy. And then what must be at the very furthermost end of complexity is something that as a matter of design requires to be tailored to each particular company, but I would with respect say that the continuum of lawful options extends to those boundaries. And it's with great respect a very big call to decide that a CPI-X design of threshold is excluded entirely off that continuum.

Tipping J I didn't understand and I wasn't quite sure Mr Dobson whether that was the Court of Appeal's view that it just simply wasn't available as a methodology or whether it was more the perceived weaknesses of the methodology that unhorsed your client so to spoke.

Dobson I apprehend Sir that because of the distinction the Court of Appeal drew between the initial and the revised, we must interpret the finding of unlawfulness in respect to the initial because the X factor didn't do a job that would screen, and that when I come to it Sir is the

Tipping J Because the methodology was common to both.

Dobson It is.

Tipping J It's the integers that were perceived to be too blunt?

Dobson Yes, that's correct and where with great respect the Court of Appeal fell into error is that how well it does the job, which is a variation the integer can reflect, is not a matter going to lawfulness, that's within the discretion.

Gault J Did the Court of Appeal see both thresholds as employing the same CPI-X methodology?

Dobson Did they see them employing?

Gault J Yes, reading the judgment they seem to introduce the CPI-X in their consideration of the revised threshold, whereas your whole submission is that this is really the same methodology in both, save that the revised has a variable for X.

Dobson Well it's a little reading the judgment Sir, but in my submission they couldn't see the two thresholds as anything but based on the same basic

design and I apprehend that the concern leading to a finding of unlawfulness was because the X factor in the initial which they focused to the exclusion of the common attributes of the rest of that design with the revised, the view that the Court of Appeal came to didn't screen at all and it's for me to persuade Your Honours that that was an error.

McGrath J Mr Dobson I wonder whether your argument that the Court of Appeal got into issues of how well that the formula was doing the job is really correct. It seems to me that they rather decided that because it wasn't having any screening function the first index, because it was therefore not having any targeting function and in those circumstances it wasn't doing what the statute required at all. Now that point's directed really to the sort of passing swipe you take on the basis of how well. I just think that's a fair analysis of what the Court of Appeal thought it was doing anyway.

Blanchard J You're going to be taking us to the Court of Appeal judgment. Is it convenient to do that now

Dobson By all means Your Honours.

Blanchard J Or would it be better to defer the answer to Justice McGrath's question until you're ready to do that.

Dobson In fact it might be better if you don't mind because to

Blanchard J I'm sure Justice McGrath won't mind provided he gets an answer.

Dobson Well to deal with it I do want to go through the positive justification first and then come back to the reasoning if that's acceptable.

McGrath J That's no problem. Just bear in mind that if you're attempted to say oh they're looking at how well the job was done, I'm here to be satisfied that was the question they were looking at, that was the basis of their decision.

Dobson Yes, Your Honour's point is that they drew an absolute distinction because the initial threshold was treated by them as not screening and not incentivising at all.

McGrath J And not incentivising at all.

Dobson And not incentivising at all.

McGrath J Well at some point I'm perfectly happy for you to come to it.

Dobson Now I do wish to come back to specific passages in Dr Gunn's affidavit in explaining the Commission's position. But just to go back to what Mr

Sundakov was contending for. The Commission sees the design threshold that he contends for as involving effectively the same amount of work as would be required for a control decision. And the Commission makes the point that that's inconsistent with targeted control because it is expecting too much of all participants in the industry. You're front-ending all the work, and both the Commission and all the companies would have to do effectively the bulk of what is needed for a control decision which is of itself a very elaborate and detailed process. I did want to make the point which Your Honour Justice Blanchard has anticipated that the view now expressed is diametrically opposed to that advocated for Unison during consultation and there's that paragraph in Dr Gunn's affidavit quoting Professor Ergas's view. Now can I just deal with the specific components of the IPPT? The X factor decided on in the first threshold was CPI, so it was CPI-CPI. Now that means that in

Anderson J Or shoe size, my shoe size.

Dobson That means that the formula recognises that there will be increases in price reflected in the consumer price index but for these businesses over the relevant period that they're reporting under this threshold, they cannot increase prices more than the extent of inflation, minus the extent of inflation, so

Tipping J In other words not at all.

Dobson Nominal

Tipping J This is a very complicated way of say no price increase.

Dobson Well the reason I take Your Honours up the hill and down again is because from the economic perspective what it means is they have to reduce their prices by the extent of CPI.

Tipping J Oh in real terms, yes.

Dobson In real terms.

Tipping J Yes, yes.

Dobson And what we come to in terms of it's ability to screen and incentivise is whether in the circumstances confronting the Commission at the time it was entitled to see that as fulfilling a screening and incentivising function. Now the Commission knew generically a reasonable amount about behaviour within the industry. It knew for example that line charges, the prices charged by these businesses, had increased only .3% in nominal terms on average for domestic customers in the 1999 to 2001 years.

Tipping J Per year?

Dobson Per year.

Blanchard J Sorry, what was that figure again?

Dobson .3% Your Honour.

Blanchard J Per year?

Dobson Yes. That meant that the inflation adjusted had dropped averaging 5.2%, and that industry-wide performance, recent performance, had to be assessed together with the warnings it had about the robustness of the company-specific information. I think it's fair characterisation that the Commission knew more about industry performance as a whole than it did about individual company performance. So if we take ourselves back to the functions that are CPI-X control regime could produce coming to the incentive aspect, the Commission was mindful that international experience on CPI-X as a form of control has shown that the less company-specific and the more related to industry standards an X factor is, the more you incentivise individual companies to beat the average if I could put it colloquially. So that there was positive reason in terms of the incentive aspect of a threshold for it to be generically expressed. Because of the concern about disincentives involved in requiring changes of price too quickly, there was also a conservative bias that at the starting point we ought to move relatively slowly. The regime is to achieve its aims over time

McGrath J Well does that have a connection with the point you made earlier about the disincentive to investment

Dobson It does Your Honour, yes, and that's particularly so with lines businesses because as Your Honours will appreciate they've got unusually long-lived assets. Some of the assets have a usable life of up to 70 years, so the advice from Dr Lawrence in *Meyrick & Associates*, and this is perhaps at a later point, but certainly the theme was there, is that given the nature of the businesses, you can expect to affect their profitability over a five-year period but probably not affect their productivity over anything less than a 10-year period, because particularly the capital investment is in relation to a very, it's a very cycle of the assets they're dealing with. So those are factors which would suggest that the initial threshold purpose of which is to incentivise companies to change their behaviour over a period of time, not move too quickly.

McGrath J Is there a source for this material Mr Dobson or is this really just your submission of what we should be inferring from

Dobson No, I can provide you Sir with the last notion about the time periods over which – that's in the *Meyrick* report. I've got a reference to that.

McGrath J You can give it to me later, I don't need you to go to it, but I'd just like to see it at some stage later.

Dobson Could I do that, yes, I may have it in my notes here somewhere Sir. So in the Commission's thinking developing the X factor in terms of an incentive aspect, you've got the industry-wide recent experience and on all that the Commission knew, you had a reasonable explanation that the industry could on average continue to make efficiency gains that matched the extent of inflation at least for another year. That's really what they've been doing. That proposal had strong support of the industry and time doesn't really permit me to take Your Honours through all of it, but Dr Gunn's affidavit, para.76, the PwC view for 18 businesses supported the concept of an initial price path where X was equal to CPI. The affidavit includes a quote from their submission 'a delay in assigning X is acceptable given current industry performance and strong support for adopting a CPI-CPI path in the interim'. He goes on and deal with other support for it in paras.86 and 87. 86 deals with Vector. Vector proposed no price increases for the next year and their CEO is recorded as making that offer to the Commission. And in 87 there's a record of an exchange between a PwC representative at one of the Commission conferences. And then 95 and 96 we get again Vector's view and the comment by one of the other businesses on Unison's position. And then at that time it moves on to para.97 which Your Honour Justice Blanchard drew attention to already. So coming back to how CPI-CPI for the initial period, bearing in mind that it was gazetted I think in June 2003, it required a first assessment at September 2003. It was publicised in terms, and I want to take Your Honours to them in the moment, foreshadowing further work by the Commission in which it would revisit what the appropriate X was. So it was treated as a starting point. But requiring the companies to respond to the CPI-CPI, did limit excess profits where they were being made, by reducing prices in real terms. It would provide incentives for efficiency gains because if the companies accepted the constraint that it represented and they wanted to maintain their profitability, obviously they've got to get efficiency gains underway otherwise they're going to lose their margins. And it would begin leading to a sharing of gains with consumers by prices being lower than they would be if they were unconstrained. Could I just briefly mention to Your Honours six other relevant factors that appropriately influenced the IPPT decision? First, the Commission had to have some thresholds in place as soon as practicable. They knew that the

companies would respond once they knew what the regime was. The regime

McGrath J It didn't have to do it immediately did it? I mean as soon as practical means when the work's been done really.

Dobson And I apprehend Sir that as part of Unison's argument, well they should have deferred for longer, because if they didn't know enough to do a more sophisticated threshold then they shouldn't have done anything at all, but I

McGrath J Well just the notion that the need for immediate action that seems to be coming through in this submission, I'm just not sure that the words that were used really support it.

Dobson I'm sorry if I said anything other than is seen as practicable Sir, because we've got the Act coming into force in August 2001; very extensive consultation through to the publication of the first threshold in the middle of 2003, so it's a period of nearly two years, but

McGrath J Yes, yes.

Tipping J Is it perhaps not so much a question of time as soon as practicable, but that it contemplates a holding action?

Dobson Um

Tipping J Or at least makes a holding action within the contemplation of the section?

Dobson Yes, that must be so, particularly when the threshold-setting power is one that they can exercise from time-to-time. It's not as if you shall do it once and then revisit it in five years time.

Tipping J It doesn't envisage perfection?

Dobson No.

Tipping J As your first shot?

Dobson No, and I don't know that the Commission would accept that the statute has an expectation of perfection at any time.

Tipping J Well, yes.

Dobson Thresholds by their nature are

Tipping J I was overstating it Mr Dobson, but it's that concept really.

Dobson It is, yes.

Tipping J You aren't necessarily going to fire your best shot first.

Dobson No, and the regime was for targeted control. It's not universal control, so the parameters had to be set consistently for a threshold. They hopefully would incentivise a change in behaviour but they didn't force anything on any company, it was of their own choice. There was a real concern, and Your Honours may have read this, acknowledged in the Court of Appeal, at what's been called 'gaining the regime'. It was apparent when it came in in 2001 that it could only operate prospectively, so there would be no calling companies to account for their conduct before the regime got up and running. One doesn't have to be very cynical that it created an opportunity for a company to say 'well let's build in a bit of fat'. Before the Commission knows enough to set a threshold, let's give ourselves a buffer, and that was recognised by the industry and quite responsibly in my submission, they encouraged the Commission to act promptly to counter that, and if I could just take Your Honours to one part of our written submissions, because it's most efficiently dealt with in paras.28 and 29 of our written submissions. Your Honours will see in para.28 we addressed Vector's stance during consultation. Vector expressed some scepticism about the need for any lines businesses to increase its prices when moving from a light-handed regulatory environment based on information disclosed to a more regulated one, and what I've given Your Honours there is a quote out of Dr Gunn's affidavit which is in turn taken from Vector. 'Vector does not consider it unreasonable that any lines business wanting to increase its prices or reduce them less than prescribed by the threshold, to attain a commercial return should demonstrate this in some way to the Commission. A further consideration leading us to the view that this approach is reasonable is that the lines businesses concerned have historically voluntarily kept their prices at allegedly sub-optimal levels, and now appear to want to reverse that approach by seeking special treatment'. So Vector was sending a signal, get on and put a line in the sand, and if businesses have individual circumstances that they say would require them to breach a CPI-CPI then they can come and tell you. And 29 deals with the submission that the Commission received from NERA, who was an economic consultancy retained for PowerCo. 'Given the balance of risks of the price path being set too low or too high, in combination with the need to implement the framework within a relatively short time, there is merit in basing initial prices on existing prices, since these have been set voluntarily by firms under the existing disclosure regime. Like other submitters, NERA implicitly acknowledged the need to set the thresholds as soon as practicable and that the thresholds could be refined as more information and evidence became available', and then we've got reference to Professor Ergas who 'while proposing a different approach to

determining the X factor, indicated that using a glide path from current prices was a valid approach', so there is this concern that the longer the Commission delayed, there was the prospect of gaining. The industry wanted to know where they stood. There was a 'buy-in' to CPI-CPI. The fourth factor I'd identify if that as the Chair of the Commission's put it in her affidavit, Miss Rebstock, the only alternative was to do nothing, and that would not advance the statutory at all and it would risk possibly causing harm to it. The fifth point is that the X factor reflected reasoned expectations about the future industry performance based on a recent past performance. It was supported by the industry, which the Commission took as signalling an acceptance that further efficiency gains of the extent of inflation were still realistic and achievable. And the sixth is that the industry knew that the threshold would be revised following further work in consultation on the level of the X factor to be applied.

Blanchard J What was the industry told about that?

Dobson If Your Honours would go to volume 4, at tab 26, we've got the media statement that accompanied the release of the thresholds, and just on the specific point about revision, if Your Honour have that you'll see on page 602 of the case on appeal, on the righthand page under the heading *Price path Threshold* - 'the methodology for resetting the price path threshold will be further developed over the next six months. There will also be further work on the levels of X to apply when the price path threshold is reset', and it went into some of the details and then over on the next page, the lefthand side, 'in respect of the assessment as at three months after the thresholds are set', it sets out what will constitute a breach. Second bullet point 'the Commission considered assessing this threshold as at 31 March 04 only, but decided on an early assessment three months after the thresholds are set was required. If electricity lines business have increased their prices since the legislation was passed, it is appropriate they are assessed to have breached this threshold sooner as opposed to later'. And then in respect of it being reset to apply from 1 April 2004, second bullet point there, 'the Commission expects that those electricity lines businesses that have been performing relatively poorly would face a higher X requiring greater price reductions and/or quality improvements to avoid breaching the threshold. The better performing electricity lines businesses would face a lower X but importantly still be required to make efficiency improvements each year to avoid breaching the threshold'.

Tipping J How long after this was promulgated was the challenge to its legality Mr Dobson?

Dobson The proceedings were commenced in May 2004.

Tipping J What time are we talking about here. 31st March 2003?

Dobson Yes Sir.

Tipping J In May 2004.

Dobson Or was it October?

Tipping J Anyway it was a number of months, or over a year?

Dobson Yes it was, the challenge wasn't commenced until the revised thresholds had been promulgated Sir.

Tipping J Okay, thank you.

Dobson And just whilst Your Honours have got that open, if you would go to the next page, 605 of the case, on the righthand page as it's reproduced you will see the Commission's communication to the industry at that time, about part 4A, just draw attention to the last sentence of the first paragraph. 'In effect the thresholds are a screening mechanism to identify businesses whose performance may require further investigation and if required control by the Commission'. Now for its part, Unison agreed that the regime should be put in place quickly and I don't need to take Your Honours back to it again but the quote from Professor Ergas in para.97 of Dr Gunn's affidavit makes that point. There is also a further reference to their position at the time and I would be grateful if Your Honours could go to this. In para.199 of Dr Gunn's affidavit there is evidence about Unison's contribution to a Threshold Conference in November 2003, and

Tipping J At paragraph?

Dobson 199 thank you Sir on page 252.

Tipping J Thank you.

Dobson Mr Sutherland, who's the Chief Executive Officer of Unison, represented it at this conference and there is a para-phrasing of his submission to the conference and I just want to draw Your Honours' attention to 199.3 'the only thing for Unison to be doing would be breaching the threshold and taking faith that Unison can demonstrate it is running an efficient and sustainable business at a higher price than the prices that are currently in the market'. So the Commission took that as a signal and it's not the only one from Unison that if the thresholds were set on an industry-wide basis and they didn't fit the mould as it were, they would have the courage of their convictions that they would come along to the Commission and explain the circumstances of a breach and justify it.

McGrath J Sorry, that's in November?

Dobson 2003

McGrath J 2003. When does that relate to the second threshold being established?

Dobson The first assessment was as of September 2003.

McGrath J Yes, thank you.

Dobson And that course which is in implicit in Mr Sutherland's statement to the Commission of breaching where justified was also suggested is appropriate by PwC representing 17 of the businesses, and the evidence of that is at para.148 of Dr Gunn's evidence. I don't want to mislead Your Honours as to the timing of this. I've now jumped back in time to May 2003, so this is before the first threshold is promulgated and

Blanchard J It's after the press statement though

Dobson Yes I think it is, yes.

Blanchard J That was March.

Dobson March, yes. Your Honours will just see in para.148 of Dr Gunn's affidavit 'PwC did not consider there was nay need to make special arrangements in the price path thresholds for businesses that perceived their prices were too low to be sustained'. The second sentence of the quote from their paper 'if an ELB is unable to sustain the low prices it has in place over the medium term without breaching a price path threshold, it has the opportunity to defend a breach during the price control investigation'. So there was recognition that with these initial thresholds that they would serve a purpose. That if there were companies whose circumstances required them to breach then that didn't require the threshold to be re-designed.

Tipping J Is that by inference a statement that an 'across the board' approach be tolerable, perhaps not ideal, but tolerable because of this individual examination that would come later?

Dobson Yes, and there is recognition that particularly at the first go there are likely to be false positives and possibly some false negatives, but that the Commission didn't need to wait till it could design a threshold that would eliminate virtually all of the false positives.

McGrath J Was Unison part of the Price Waterhouse Coopers Group?

Dobson No it wasn't Sir. At the beginning state it was Network Hawke's Bay and it paddled its own canoe and retained Professor Ergas. But we come back to the question 'well how can the Commission treat this as screening', and the point is that in the context of what it knew about the industry at the time, it was appropriate to screen for companies that were not keeping their prices constant in nominal terms, because the industry supported that because the recent experience suggested that the extent of efficiencies gains could continue to be made at that level so that incentivising companies to continue with the trend to greater efficiency is appropriate and those who didn't would be drawn to the Commission's attention and in circumstances their breach then considered.

Tipping J It's not suggested is it that this is no screen at all, or is it suggested against you that this is no screen at all? It may be a crude screen, forgive the language, but the argument against you is that this is no screen at all.

Dobson Well if I come to the Court of Appeal reasoning I apprehend that it is on the basis that it didn't screen at all, which must implicitly at least adopt the criticism that Unison makes which is that the mere fact that a monopoly has increased its prices, doesn't tell you anything about how efficiently it's operating.

Anderson J If it's caught someone it must have done some sort of screening. I mean if it didn't screen well why is Unison complaining?

Dobson Well it has screened Sir but

Anderson J He got caught by it.

Dobson Well my learned friend said it caught almost everyone. We can go into the details of that if Your Honours have more time, but I don't think it advances the debate. The point is that Unison's proposition could only hold with the qualifier that in the absence of other information the mere fact that a company's increased its prices tells you nothing about it, but of course the Commission wasn't in a vacuum here. It did know what the state of the industry was at least generically, whilst it had some reservations about the robustness of the data on individual companies, so it knew that the recent performance it suggested that efficiency improvements at about the rate of inflation could be expected, so a threshold that incentivised the continuation of recent behaviour and screened out for further consideration those who weren't meeting the industry norm, does do a screening function.

Anderson J It's like a net isn't it? If you catch something in the net and it turns out to be a fish then it's had some sort of efficiency.

Gault J I don't think the point Mr Dobson that it would not catch a company that was making excess profits at the time this regime began and continued to do so without increasing prices.

Dobson Yes, that's a false negative and that proposition was certainly a major part of Unison's criticism. The answer to it Your Honour is that over time every business that is in that situation if they are to avoid a breach would have to change their behaviour. They will have to forego any price increases and therefore the level of excess profits will come down. Now it's a little artificial because the initial threshold didn't stay in place for any longer than one period but had it been as drastic as that then after a period of time, unless the excess profit maker is improving its efficiency, the extent of excess profits will be shrunk by the requirement that it conform. What it doesn't do is guarantee that it will be revealed on the first assessment.

Gault J And I suppose the question that arises from that is how practical is that issue? How great was the likelihood that there were companies making excess profits, having regard to the fact that there was a regime albeit unsatisfactory in place before.

Dobson Well one of the differences in the examples tested in the lower Courts is that Unison has postulated a company thats prices were 18% above what they needed to be for an efficient level and the Court of Appeal and the High Court have both accepted that there isn't evidence of an out-liner as bad as that, and although by the time the initial thresholds were set there couldn't be any confidence on a company-specific basis about how far out the outliers were. Dealing with it on an industry norm basis recent performance suggested yes we will constrain anybody who is not increasing efficiency at the rate of the CPI. That will begin the process of constraining the extraction of excess profits, and by the time the revised thresholds came in, although there wasn't a direct measurement of the efficiency of prices, the *Meyrick* analysis measured two effectively derivatives of that by doing a relative productivity assessment of all the companies and a relative probability assessment, so when we come to talk about the revised thresholds, the X factor was revisited and fine-tuned by grading companies into groups on their relative productivity and the relative profitability.

Gault J That grading also had the benefit of the disclosure regime in the interim of course.

Dobson Yes it did, yes.

Gault J I was just thinking about the initial one and the false negatives and how big a defect is that in practical terms?

Dobson Well it's a little bit difficult to answer because we can't reconstruct Your Honour now whether there were outliers and if so, by how much.

Tipping J Isn't there an answer to this at least provisionally and I'll be interested to hear Mr Goddard on this? If the criticism is that the faults negatives are not necessarily caught by the initial screen, they're undoubtedly not going to be caught by doing nothing.

Dobson Absolutely not. That's the point the Chair made in her affidavit Sir, yes, particularly when the industry has encouraged a line in the sand if I could crudely put it that

Tipping J And if the evidence is, and it doesn't seem to be challenged, that the options were either between doing nothing and doing this, then you can hardly criticise it against doing nothing because it wasn't any advance on nothing.

Dobson No, and I apprehend that, although I don't know whether my learned friend would concede this, but I think his expectation of what was required would inevitably have taken longer. I'm not quite sure where Unison's case now sits relative to the amount of work that was done to the revised thresholds. But I'm not sure Sir that I've completely answered your question. You are concerned that its function as a screen might be in jeopardy if the industry had outliers whose behaviour could safely hide under the threshold for a long period of time.

Gault J Well that is the point that is made against you

Dobson Yes.

Gault J And I was just interested in your response to it.

Dobson Well the first response is that there is no evidence of companies as far out of line as Unison's example that the lower Courts would require and indeed the confirmation that the parameters of behaviour are more-or-less what the Commission expected is reflected in the revised work done by *Meyrick* on productivity and profitability. And if it's helpful to Your Honours I can take you to those charts and just identify what the range of productivity and profitability is.

Blanchard J When was the Commission starting to get some benefit from the information regime? When was it starting to collect information by that means relative to the time when it was thinking about what to do about the initial threshold? What I'm interested in is the extent to which the

preparation of the first threshold was rubbing up against the information and one was working on another.

Dobson There is no evidence that the operation or the information disclosure regime materially assisted the Commission at the time of the initial threshold. Rather I would put it in this sense Sir, that the Commission had the comfort that over time the disclosure regime would materially improve the quality of the other information it had, so it was an influence on the design of the thresholds in a prospective sense, but I don't think I can point Your Honour to any evidence that

Blanchard J If you had one of these companies that perhaps would get the benefit of a false negative, on what I've read it would seem that the behaviour there would have been relatively extreme and that the information should start picking that up fairly swiftly. Is that fair comment?

Dobson It is. The only thing I would be a little hesitant about Sir is how quickly it happens, and certainly the Commission can be comfortable that over time and outlier will be revealed one way or the other, and I don't accept that it is a material criticism of the lawfulness of the thresholds if that period is say seven rather than three years.

Blanchard J It's going to take that long?

Dobson There isn't any reliable evidence Sir on how long it might take because we haven't identified the company that is the worst outlier. Certainly the glide path is intended to bring the average of each of the groups. Oh I'm sorry I'm now jumping to talking about the revised threshold, but I think it's necessary to do that to answer your question. To bring them close to average performance for that group over a five-year period.

Blanchard J Thank you.

Dobson What might be instructive to do is to take Your Honours to a graph that was produced. It's near the back of volume 7 of the case, page 1094 at tab 39. One of the features of the way the argument in the High Court Your Honours is that we had competition by competing graphs. I won't take Your Honours to the previous tab which were graphs that were produced for Unison showing the period of time if would take to catch a given outlier. I'll allow my friend to take those to you if he wants to, but in response to that the Commission produced to the High Court the series of graphs about the way the glide path works and again I must apologise for jumping forward and explaining the Commission's position by reference to the revised threshold, but the design of the thresholds I think needs to be understood and this is the way of demonstrating it. When we came to the revised thresholds there were four groups of X factor and they would be an

X of either +2, +1, 0 or –1, and that is because the initial threshold just had CPI-X, the X being CPI. The debate between the initial and the revised thresholds led to the design of more sophistication in X so that it represented first a B factor, which was the industry-wide expected increase in efficiency which was set at 1%. So the Commission's first assumption was that across the industry we can expect 1% improvement in efficiency a year. And there are then two components in what was called the C-factor. C1 reflecting productivity and C2 profitability. So the *Meyrick* analysis did a relative measure of both productivity and profitability in which businesses were marked with either +1, 0, -1, and the gradations in that could have accommodated more pluses or minuses if the result of the research suggested that there was a wider spread of performance among the company, so it wasn't pre-determined that there would be four groups and it wasn't pre-determined about how many, it is just that the result of the research tended to break them into three groups for each productivity and profitability. What these graphs are intended to demonstrate is the way the glide path works, dealing in the first little part of it with the initial and then with the revised. So the first graph that Your Honours will have at 1094 is for a company where the prices are above efficient level, so that the company has been scored with an X factor of +2.

Tipping J That's minus plus 2.

Dobson Exactly, it's CPI-+2 Sir, so that say inflation is 2.5%, CPI-X. If the X is +2, it means that that company can only increase its prices by .5. So the effect of that over the period of the reset threshold, as Your Honours will see at the start, that the green line, there's the price path consistent with the expected; improvements in industry-wide efficiency and then the red line has a starting price above efficient levels and Your Honours will see if the little black notation in the middle of the page due to either below average productivity, i.e., the company's not as productive as the Commission would expect it to be, or above average profitability. It's making more, and the note is quite important. The Commission's analysis did not identify any businesses with both below-average productivity – i.e. it's not very efficient at all and above-average profitability. And obviously the X factors could have been tweaked to take account of that if that had been the case. So what you get is a price path which allows them to increase prices by.5% per annum saying in the situation where the CPI is 2.5. So to stay within this incentive, to avoid any dialogue with the Commission, the company has to improve its efficiency if it wants to retain its level of return and limit its changes in price to .5% per annum. If we turn over the page we get the way the price path works for an averagely efficient business, and here it's X factor will be +1, which means that its got, the result of its C-factors cancel each other out and it's got 0, so it's just presumed to be able to make efficiency gains to the extent of 1% per year in accordance with the expectations of the whole industry. And in that

situation it will be allowed to increase its prices by 1.5% assuming that CPI was 2.5%. So it will have to in nominal terms reduce its prices by 1%. We then have the situation of a company that is below average efficient level and the Commission found some that were in that sense where the X factor is reduced to 0, i.e. you take away from this company the expectation it will meet the industry average in B-factor +1 because it's got a C-factor of –1, so the +1 on the B and a –1 on C cancel each other out, and it is entitled to increase its prices, as again assuming 2.5% by 1.5%.

Tipping J 2.5

Dobson 2.5, I'm sorry.

Tipping J Because X is zero.

Dobson Yes, so they can match inflation.

McGrath J Match inflation because you're matching expected efficiency.

Dobson You're

McGrath J Your price path is consistent with expected improvements

Dobson Yes, because there are

McGrath J And efficiency and that turns out that you can just match inflation in you pricing,

Dobson Yes, there are signals sent that unlike their average, the B-factor, where the whole industry expected to improve by 1%, your productivity and profitability measures suggest that that should be cancelled out in your case, and there is the more extreme situation where X is of –1, where there'll be negative findings on both productivity and profitability factors where the business by its threshold will actually be invited to increase its prices because the Commission sees signals that it's actually not charging enough, so that where inflation is 2.5% it's allowed to increase its prices by 3.5%.

Tipping J That's a case where a minus plus a minus equals a plus? In other words

Dobson Yes it is. CPI—1=+1.

Tipping J That's right.

Dobson Mr Goddard's a mathematician but I think I got that right didn't I? Yes.

Anderson J And the prices would be below average efficient level because they mightn't take account for example in future development.

Dobson Yes, there can be a range of factors idiosyncratic to the individual companies, but what this is sending is a signal which in some sense as the regulator is just as worrying as the ones who are over-charging, because here's a business not being managed well enough. It ought to be encouraged to increase its prices, and that's another aspect of the regime where it incentivises moving into more efficient levels.

Tipping J Do these represent the actual categories? These are not theoretical are they or are these the actual four categories?

Dobson No these are the four categories. It goes from an X of –1

Tipping J To an X of +2.

Dobson Yes, and I'm sorry I've just seen the time and after the adjournment I will take Your Honours to the *Meyrick* graphs that built up those C1 and C2 factors. May it please Your Honours.

Blanchard J Thank you. We will take the adjournment.

1.02pm Court Adjourned
2.16pm Court Resumed

Dobson Thank you Your Honours. I just want to make two more points about the graphs I was describing to Your Honours before lunch at 1094 and following of the case. There are two points on which to emphasise. First if Your Honours would turn to the last of the graphs at 1098, that is intended to demonstrate the different ways in which a PO adjustment would work when compared with the glide path so it takes me make back to a question Your Honour Justice McGrath asked relatively early in the morning about what the glide path is, and this

Blanchard J How is that PO to you?

Dobson That's the description I've adopted Sir, as to whether it's

Tipping J "P zero" I thought.

Anderson J "P zero"

Dobson "P zero", oh well

Blanchard J It's too much like 'peanut'.

Dobson Well the difference between the prospect of a "P zero", that is a starting point adjustment either up or down, Your Honours will see is relatively dramatic on the impact it has on the business, whereas they perceived a traction in terms of designing at least the threshold is that the glide path moves to the same end point but takes a period of time to get there. Now of the graphs, the one that is most constraining, and this brings me to the question Your Honour Justice Gault was asking about how long it might not catch an outlier, the point that the first graph at 1094 demonstrates for the business judged to already have prices that are an above-average level so that the constraint will be the most, Your Honours will see the graph demonstrates that the initial price path, if continued, would have constrained prices even for that group to a greater extent. It would have constrained more than the price path permitted in the revised threshold, and that threshold is the one that identifies in terms of the further work done of the group needing the largest constraint. So in a sense the initial threshold Your Honour would have enforced a compounding change in prices more quickly than the revised which we can reasonably infer is made with the benefit of substantially at a greater level of information. Now the source of the different 'C' factors is derived from the work of *Meyrick and Associates*, and if I could trouble Your Honours to take volume 6, the buff coloured one, just briefly under tab 29

Blanchard J Are we finished with these ones?

Dobson Yes Your Honour, thank you. And if Your Honours could turn first please to page 885, under tab 29, the is the December 2003 report of Dr Lawrence's firm *Meyrick and Associates*, and the table on page 885 produces the results of one of the two comparative analyses that were undertaken. This measured productivity on a relative basis between the businesses. Your Honours will see at the very top of the page reference to MTFP, multilateral total factor productivity analysis which was applied by these experts to do this comparative assessment. Your Honours will see that the businesses are ranked on the basis of their average outputs for the period 1999 to 2003, and just to draw Your Honours' attention to Nelson Electricity was ranked as the second most productive, second most efficient, we'll see Vector ranked at 5 and Unison at 16. So that was the component for one of the C-factors. If Your Honours turn over to page 890 you will see the result again of an industry-wide assessment of relative profitability by comparison of tax adjusted residual rates of return. They could only be estimates, and Your Honours will see in the 4 year average in the righthand column a little notation a next to three of the businesses, including United Networks and Unison, that they're on a three-year

average, that is because in the period being surveyed, United Networks assets were required by three other companies including Unison, so that created a difficulty in getting averages over the entire period, but what it shows is the range of returns and if we exclude Nelson Electricity, which I'll come back to and Unison, which by the end of the assessment period no longer existed, the highest tax adjusted residual rate of return is that for Counties at some 10%. And the returns go down from that to an alarming 1.3% at the bottom. Now just in terms of the way these two measures fit together, taken on its own Your Honours, Nelson Electricity at 15% might look as if it is well above the rate of return that should be expected, and on that single factor looks as if it needs attention, but if one comes back to the chart at 885, it's ranked very well in productivity which suggests that it's very efficient, so the contribution to its above-average rate of return may to a significant extent be explained by its relatively high level of efficiency, and the design of the revised threshold X factor of the CI and C2 was intended to take that factor into account. Now whilst Your Honours are at the *Meyrick* report, could I just ask you to turn over to page 891, because Your Honour Justice Blanchard asked me about evidence of the period of time required for assessment, and we see here under the heading 6.4, the second paragraph 'given the capital intensive nature of electricity lines businesses and the long-lived nature of the assets involved, it is unrealistic to expect lines businesses to be able to remove large productivity gaps in a short space of time. A timeframe of a decade, or two five-year regulatory periods is likely to be necessary for businesses performing near the bottom of the range to lift themselves into the middle of the pack. This timeframe would allow sufficient time for asset bases to be adjusted significantly, new work practices to be adopted and bedded down. It is however reasonable to expect profitability levels to be adjusted over a shorter period, say one regulatory period of five years'. So that's the source Your Honour of the Commission's view about the timeframes. The next paragraph of that page recognises the debate that had gone on about the range of factors. Your Honours will see near the foot of the paragraph 'given the need to minimise risks given the variable quality of the available data and residual uncertainties, we reduce the range of C-factors to -–, 0 and +1'. And then a point which is relevant to the rate of change expected, the points made in the last paragraph 'for a similar spread of tax adjusted residual rates of return, the same range of factors would imply adjustment of average residual returns for the low and high return groups respectively to the average of the medium return group over less than 10 years. This is because the rate of return component will usually make up less than half of total annual costs. Therefore a 1 percent change in total revenue has a magnified effect on the residual rate of return'. So that if we're concerned about the period that would be taken to bring down the rates of return enjoyed, the price gap proceeds on the assumption that there'll be a magnified effect. If you have a 2% reduction in allowable prices compounding per year, you will expect to have a

greater than 2% compounding impact on the level of the rate of return. That's how the design is explained. Having done that I'd now like to come to the reasoning of the Court of Appeal, mindful of Your Honour Justice McGrath's question that you're not sure that there is in its reasoning a qualitative how well they did it rather something more absolute, and I'll endeavour just by taking Your Honours to a couple of paragraphs to explain why the Commission sees the finding on IPPT in that way. If I could begin Your Honours by taking you to para.44 of the judgment at page 120 of the case. At the very foot of page 120 the judgment commented 'in other words the business it has breached is one that is identified itself as a candidate for control, subject of course to having the opportunity for a dialogue with the Commission about whether control should be imposed'. And in 45, 'acceptance of Unison's argument that the statutory purpose of the threshold is to perform a screening, filtering function which over time should capture those who are potential candidates for control. The statute does not require anything more than a rough proximation'. And then if I could bring Your Honours forward to the finding in para.60

Tipping J You accept that, 46, as I recall your written submissions is that right? You accept that formulation as being, or am I thinking of the wrong

Dobson No, the Commission does not accept that a threshold has to identify candidates for control. The essence of the difference between the Commission and Unison, is that Unison says 'if you breach the threshold you have to be eligible for control', and in accepting Unison's argument we take the Court of Appeal to have embraced that as a requirement, i.e. a breach of the threshold has to tell the Commission this is a company that is prima facie to be controlled, subject to their saying no there are unusual circumstances which

Blanchard J Isn't that what that says? Capture those who are potential

Dobson Well the reason why I was a little bit diffident about being precise in the question from Your Honour is that it depends on the degree of the potentiality

Blanchard J Oh obviously.

Dobson But certainly

McGrath J A rough approximation.

Dobson well in the literal sense they are potential candidates for control in the negative way that they couldn't be candidates unless they had breached.

Tipping J I don't see the word 'potential' meaning prima facie.

Dobson If it's less than that then that's fine, but if we come on, and the reason I've taken Your Honour to those two paragraphs is because if we come on to their finding in para.60, this is where they express the conclusion that the initial threshold did not meet the statutory purpose, and inefficient and high-charging business could put itself out of reach of the potential for control simply by maintaining its monopoly price and no quality service. They then make the finding there is no element of screening at all.

Tipping J Well in that aspect they're saying. I mean that must be so as far as it goes, but I don't see that as necessarily justifying the threshold because it doesn't effect any screening purpose.

Dobson Well I take the, Your Honour, I take the conclusion at the start of the paragraph to be justified by the finding that it doesn't do any screening at all and therefore it doesn't meet the statutory purpose.

Tipping J It's a non sequitur. If it says simply because it doesn't catch somebody, it doesn't do any screening. If the size of the mesh is such that it lets people through, metaphorically, that doesn't mean to say it doesn't catch anybody. This I would have thought was helpful to you.

Dobson Yes, but

Tipping J But I may be misreading it Mr Dobson. I didn't see it as logically following that if you let a certain category through, it necessarily performed no screening function.

Dobson Well with great respect Sir we take the sentence I've last drawn your attention to to mean that inevitably. There is no element of screening at all and that's what the Commission would respectfully challenge.

Tipping J Well that's why I'm raising it because I don't think that follows, at least on the face of the two sentences. The idea that because you miss somebody you should catch doesn't mean to say you don't catch anybody.

Dobson Well if we go back to 46 and treat the reference to potential candidates of control as just having to identify some but not be exhaustive about those that should then be controlled, and bring that forward to 60, one would have thought that the Court of Appeal would have said 'it doesn't screen enough', because it will (**inaudible)** by some candidates.

Tipping J I'm with you provisionally, subject to hearing Mr Goddard. I don't think they can say that there's no element of screening at all

Dobson No

Tipping J Just because you miss somebody you might desirably catch.

Dobson Yes.

Anderson J In any event in your position is that if it screens it's screening for the purposes of having a look at

Dobson Yes, and, well more than that Sir. It's screening by identifying companies that are not conforming with a glide path which past experience tells the Commission is a reasonable expectation for the extent of improvement over time in the efficiency of their business. Now the reason for not meeting that standard may be a pro-competitive one or it may be one which goes on and identifies conduct contrary to the purpose statement.

Anderson J It identifies businesses that you look at in fulfilling your statutory purposes.

Dobson Yes Sir, yes Sir.

Anderson J Which is a shade different from saying it's screening them for control.

Dobson It is, well what the Commission is understandably to is if the Court of Appeal is correct that screening for control has any implication that there's a presumption that because they've breached they did go into control, then that is attributing more to the threshold than the statutory purpose requires.

Tipping J But this crucial paragraph 60 ends up with the statement that it demonstrates the bluntness of the initial threshold. I don't understand 'bluntness' to equate unlawfulness.

Dobson No, and that's part of the justification coming to the point that concerned His Honour Justice McGrath why the Commission with great respect treats this reasoning as saying well how well does it do it? It's too blunt in doing it. But if I could just progress through the paragraph, because it is the critical one, it then goes on that 'indeed is a disincentive to act in a manner that will achieve the objectives'. Well it may be a disincentive in the short term, but that is redolent of an expectation that a single response to the initial threshold is intended to achieve the whole statutory purpose, which of course it's not.

McGrath J Which part of – are you still on para.60.

Dobson I'm still in the middle of 60 Sir, I'm sorry it's a little too cryptic. It's the same sentence that starts 'there is no element of screening at all in that'

McGrath J Yes.

Dobson It goes 'and indeed a disincentive'.

McGrath J Yes, I'm sorry, thank you.

Dobson So the Court of Appeal's finding of inadequacy in the initial threshold is because of their characterisation that it doesn't screen at all. We say it does, and that they say the implication is it's contrary to statutory purposes because it disincentivises when thresholds are intended to incentivise, but the response the Commission gives on the incentivising aspect Sir is that it can only be treated as a disincentive if the critic starts from the expectation that the single response to the first assessment is intended to achieve the statutory purpose, and with great respect that can't be the case. In just dealing the CPI-CPI, it does incentive. For all those businesses who don't want to be troubled by having to deal with the Commission, they will be incentivised to make sure that they constrain any change in price in real terms to the extent of movement in the CPI.

Tipping J Wouldn't it be more accurate to say that instead of this disincentive that there is a general incentive which doesn't apply to all?

Dobson Absolutely, and I'd be comfortable with that, because the threshold accepts that there will be false positives and false negatives, but for the generality of the industry in terms of what the Commission knew of its state at the time of the initial threshold for most of them it would be a positive incentive.

McGrath J I see the point Mr Dobson.

Dobson And it's inviting this Court to take the different view of the initial threshold to that reflected in para.60 which is the basis for the Commission's submission that they were wrong in relation to it, and if they are judging its lawfulness by the bluntness of what it does, that is in classic terms evaluating how well it does it rather than whether it does it at all or not.

Tipping J Are you going to say anything about para.61 Mr Dobson?

Dobson Well just a little but

Tipping J I'm not inviting you to be loquacious but I must say that leapt off the page and it seems with great respect to miss the point.

Dobson Yes.

Tipping J The answer doesn't respond to the problem.

Dobson Yes.

Tipping J The idea that that you can't be achieving anything if you do nothing.

Dobson No, but

Tipping J It's better to achieve a little than not achieve anything.

Dobson Yes.

Tipping J No I thought that was the point your client was making there and the answer is a non sequitur.

Dobson Yes, absolutely Sir. I apprehend that the background to para.61 might have been, and I hope I don't do any disservice to my learned friend but a point Unison made is that if the Commission couldn't design a better threshold it should have deferred and not done one at all. There were two answers to that. One was statutory imperative to do it as soon as practicable, which means that as soon as you are comfortable you at some point on the continuum of what will be lawful you do it. And that is in circumstances where the industry was urging it, and secondly the regime is intended to be improved over time as is its application, so we don't see that as appropriately reflecting the statutory imperative on timing.

Gault J Are not the purposes to be viewed in relation to the whole conduct of the Commission under part 4A rather than incidents one by one?

Dobson Absolutely Sir, and

Gault J Unless those incidents are contrary to the purposes, so long as overall they contribute to the achievement of purpose, that's all that section requires isn't it?

Dobson Absolutely, and that's another respect which one might treat the Court of Appeal's reasoning as assessing how well, because the thresholds don't have to meet the statutory purpose on their own. They're only one component of it. The point I endeavoured to make this morning. Now what is implicit in the Court of Appeal's reasoning is that it expects something further along the continuum which Unison would propose requires something by way of a more company-specific threshold, and in our respectful submission there is nothing in the statutory purpose of the requirements of thresholds that requires it to work on an individualised company basis.

Tipping J In short they say against you don't they that you shouldn't have done anything until you were further along this continuum that you're referring to? Is that a fair encapsulation of the case against you?

Dobson Certainly that more should have been done before the initial threshold was promulgated Sir. I'm not sure that they accept that it would necessarily have taken longer. I think they may say that differently directed the Commission might have got to an answer and inevitably one asks well how different would it be

Tipping J But I wasn't really talking in time terms, I was talking in the sense that they shouldn't have struck at all until they were further along this continuum of specificity.

Dobson Yes.

Tipping J Well perhaps we'll wait and see what's said.

Dobson Yes, I take that to be the essence of Unison's position Sir, yes. I was going to take Your Honours through the points that are made at paras.72 and 74 of our written submissions, drawing the distinction between what would be required for a PO adjustment and the form of thresholds. Those are important points but I don't think I'll take the time now of the Court but they are an answer to the form of criticism that Mr Sundakov raised. Inevitably it's our submission Unison's wish would have been for a threshold that required all the companies to do substantially more work and correspondingly the Commission to do more work and we say that that itself runs a risk of being inconsistent with the statutory purpose. The other point about the Court of Appeal reasoning is that there is an inconsistency in the reasoning in para.60 that we've just gone through and the reasons given for accepting the lawfulness of the revised threshold, because they accepted the revised threshold did screen and did incentivise, and in our respectful submission, having come to that view they are accepting that the basic design works and can only be making a finding against the initial by an assessment of how well it does it rather than whether it does it at all.

McGrath J Well they really though that with the revised thresholds there was an element of screening that on their view wasn't present in, as they indicated in para.60 of the initial thresholds wasn't it

Dobson Yes.

McGrath J And once they had got to that point that there was some element of screening it was a question of whether it was enough and your argument would apply.

Dobson Yes.

McGrath J That's what I thought they were doing in relation to the revised thresholds.

Dobson But the premise that it does screen requires one to go back and say well can that be reconciled with the contrary finding on the initial one, because the Commission's view is that they both screen in an effectively similar way.

McGrath J But I think you in your submissions this morning have explained why you say they do screen. In an effectively similar way, well that I suppose is the real issue isn't it, whether there is a significant difference in the second element that says something about the first

Dobson Well one can see how it is easier for a review in Court to recognise that there is screening where there are gradations in the X factor

McGrath J Yes, yes.

Dobson But my point with respect Sir is that the existence of those gradations doesn't turn it into a screening device when an industry-wide X factor doesn't. If one starts with the position confronting the Commission when the initial threshold's put in place, it knows enough about the industry-wide behaviour to say we'll promulgate an expectation that the companies can constrain their extent of change and movement and prices by X. When they come to revise, they say we now know more about them

McGrath J Yes.

Dobson And we will tailor our expectations within groups, but we are still signifying by X, an expectation of the extent of constraint on changing prices, so the two X's measure the same thing - one has more detail built into it than the other.

Tipping J Are you about to leave the Court of Appeal judgment Mr Dobson or are you going elsewhere in it?

Dobson I was going to, but I'm very happy to answer any other questions Sir.

Tipping J I just wondered if, I was a little puzzled by para.32 on page 118 of the case. Puzzled isn't perhaps quite the word, but it caught my eye because I just wonder whether this is where in your client's argument things started

to go wrong when they talk about 'Unison's argument is that the thresholds do not achieve the statutory purpose'. It's not so much achieving it as it is towards contributing towards its achievement.

Dobson Yes, very much so, and over time and as only one component – I'm sorry I'm starting to sound like a

Tipping J Yes, I'm not asking you to sort of go through it all over again.

Dobson Yes.

Tipping J And then in the last sentence of that paragraph we do seem to be into an extent issue rather than a 'within four corners' issue.

Dobson Thank you, yes. I should have made that point in answer to His Honour Justice McGrath. I'm grateful Sir.

Tipping J Well I've just looked at the reasoning in here fairly closely to see if I could see where they were coming from and that point of departure struck me as possibly being significant.

Dobson Yes, so I'm grateful for that Sir and respectfully adopted. I don't anticipate that I should address Your Honours in any more detail about the independent characteristics of the revised threshold. It is only relevant to the challenge to the Court of Appeal finding against the Commission to the extent of the inconsistency I've endeavoured to describe. Could I just however before leaving that, take Your Honours to the decision paper on the revised thresholds which Your Honours will find in volume 3, tab 22, starting at page 388.

Anderson J Sorry I missed that Mr Dobson, what number?

Dobson It's in volume 3 Sir, the mauve coloured one under tab 2.

Anderson J Thank you.

Dobson Now this is the threshold's decision. Your Honours will see that this is some 63 pages long and there was a similarly detailed decision paper issued in respect of the initial thresholds. I just wanted to take Your Honours briefly to paras.100 to 102 because although it's easy to get lost in the technical detail, there is there a short explanation of what the Commission thought it was doing which is relevant to part of my learned friend's challenge. On page 416, halfway down the page under the heading *Role of the thresholds* Your Honours will see 'acknowledgement by the Commission of arguments by Unison and PowerCo, that to meet all of the objectives of the Purpose Statement through the thresholds is

inappropriate, with which the Commission obviously agrees. The Commission acknowledges that the Purpose Statement will not necessarily be fully achieved in the case of every lines business by the price path and quality thresholds alone. While the Commission considers that lines businesses should regard the declaration of control as an outcome to be avoided where possible, the purpose of the targeted control regime may not be achieved if lines businesses endeavour to avoid breaching the thresholds under all circumstances or at all costs. For instance, although the price path threshold is conceptually similar to the various forms of CPI-X price control that regulators commonly use in other jurisdictions, it differs in important respects. Under the targeted control regime, the price path threshold is an instrument of control

Blanchard J Not.

Dobson Is not an instrument of control, thank you Your Honours, 'but a screening mechanism to identify businesses whose performance may warrant control'. Your Honours are obviously far better at reading silently than I am aloud so I won't go on, but 102 is pertinent as well just in terms of the explanation for what the Commission was doing.

Tipping J This is written specifically in relation to the revised is it?

Dobson Revised, yes Sir.

Tipping J But it's a reasonable inference that they similarly interacted themselves in relation to the initial,

Dobson Yes.

Tipping J Is that what you're suggesting Mr Dobson?

Dobson Yes it is, yes. I don't intend addressing Your Honours on anything going to relief or discretion at this stage, nor do I come back to one of the starting points I made which is that the regime is working. If we get into relief it may be appropriate for me to just draw Your Honours' attention to some parts of the submissions that deal with that. So unless Your Honours have question, there are just two housekeeping matters in terms of questions we've had earlier in the day. Your Honour Justice McGrath asked for specific references about the debate on the degree of business specificity that the thresholds ought to address. I won't take Your Honours through all of them but it's all very good reading. In my submission Dr Gunn's affidavit, paras.20, 21, 27, 36, 88,154, and in particular the first paragraph of the quote, and 188, again the first paragraph of the quotation. Now I think I did say that it was pervasive and indeed it is but those are paragraphs that do record the debate that went on

about the tension Sir between the attributes of an industry-wide one that will incentivise more and the

McGrath J That's what I was wanting to see if there was some material to look at rather than just really relying on what your submission said to us.

Dobson And if I could trouble the Registrar, I've also got the explanatory note which addresses the point Your Honour Justice Blanchard asked about specific acknowledgement of the CPI-X attribute in the amendment in 2001. Again I won't read it to Your Honours but the passage that is relevant relates to clause 14 and at the bottom of that page 4 Your Honours will see four lines from the bottom, starting with the 'provisions allow' and that plus the rest of the commentary over on the top of page 5 puts into context the Parliamentary aspiration to enable CPI-X.

McGrath J And what's the provision now and the statute it relates to?

Dobson This relates to amendments to ss.70 to 74 Sir that I found in part 5

McGrath J Which you referred to this morning.

Dobson Yes.

Tipping J It's para.20 of your written submissions. You make the point there Mr Dobson, 'this is in support of

Dobson Yes it is Sir, yes, and the point in terms of an aid to statutory interpretation for the purpose of part 4A is that if it does progress to control, then the usual statutory test for control under part 5 is substituted, and we have now got

McGrath J But with a special purpose

Dobson And we have now got in part 4 recognition that CPI-X form of price control may be appropriate, hence its relevance to the threshold. Unless Your Honours have questions on the matters I've covered those are the submissions on the challenge to the finding on IPPT.

Blanchard J Yes, thank you Mr Dobson.

Dobson May it please Your Honours.

Blanchard J Now Mr Goddard.

Goddard Your Honour. I have a road-map of the oral submissions that I propose to make. I'm going to need to modify that in one or two respects, but if I

could give the Court copies of that. Before I turn to that first question what the thresholds are meant to do, it's perhaps helpful to come back to a question that Justice Tipping asked my learned friend what must Unison show, and in my submission Unison should succeed and the thresholds should be set aside if it establishes either of two things. First that the Commission misunderstood the purpose which thresholds serve in the statutory scheme and misdirected itself on this question of law. If Unison shows that in respect of either or both thresholds the relevant thresholds are unlawful and should be set aside. Or second, and I think this is very close to Your Honour Justice Tipping's wording put to my learned friend, that the threshold cannot reasonably serve the purpose which it is intended to serve within the statutory scheme.

Tipping J Cannot reasonably serve its statutory purpose?

Goddard Yes, that would be a shorter way of putting it Sir. But I did just want to pick up that point the purpose that the thresholds are intended to serve within the statutory scheme because that's something I'm going to spend a little bit of time on - the distinction between the broad purpose of part 4A and the purpose that this particular instrument serves within the statutory scheme the way in which this instrument is intended to contribute to the overall purpose, because in my submission it's not good enough for the Commission to say oh, having regard to this BIG picture purpose, we're going to make thresholds that look like this, if in fact Parliament had a conception of the role which thresholds were intended to serve, that is prescribed by the statutory scheme and which these thresholds do not serve.

McGrath J And this is taking us away from the specific purpose provision for part 4A and it's starting to, well having regard to that in the background, look more particularly at the provisions giving the power to make a threshold decision?

Goddard Exactly Sir.

McGrath J Thank you.

Goddard So it's saying this is what the Commission was doing. When it was doing this what should it have been seeking to achieve? Why did Parliament tell the Commission to set thresholds? What did Parliament have in mind in asking the Commission to make this type of instrument? Because that's an extremely important question. It's the question which in my submission lies at the heart of this case. It's a question of statutory interpretation and what I'm going to step through and I anticipate I may need to take some time given the indications of the Court, is what thresholds are for; what the Commission should have set out to achieve in making a decision on

thresholds, and then I'm going to do something that my learned friend didn't do, take the Court to the initial threshold decision and look at what the Commission actually thought it was doing, what it set out to do. Now in the Court of Appeal Unison succeeded on the second of those limbs, the argument that the initial thresholds were simply incapable of serving the purpose of a threshold under the statutory scheme. But I didn't need to get that far. A decision by a decision-maker may fall within what my learned friend referred to as the continuum of permissible decisions and still be illegal because in getting to that decision, the decision-maker asked itself the wrong question. In my submission at the point where the Court is satisfied that the decision-maker asked itself the wrong question, it's not good enough for the decision-maker to say 'oh, but I could have asked myself the right question and still got to this point'. At that point the Court must set the decision aside and sent it back to the decision-maker to ask itself the right question and to bring its expertise to bear on responding to that question in the light of the law properly understood

Tipping J Is this wrong question thesis a surrogate for misunderstanding the purpose of the threshold?

Goddard Yes.

Tipping J It's the same point, right?

Goddard It's the same point Sir, exactly. And I emphasise this distinction between the purpose of the threshold and the purpose of the regime as a whole precisely because Unison's complaint is that the Commission has taken its own view of what a regulatory regime might look like that served the broad purpose identified in s.57E and has not followed the specific road-map for how to pursue that purpose that was prescribed by Parliament in part 4A.

Tipping J When you posed the proposition which I've measured as what is the purpose of a threshold as against the broad purpose of part 4A, and I understand the distinction, but wouldn't the purpose of a threshold necessarily be to aid the purpose of part 4A?

Goddard Yes but it's not just that. Of course it must aid the purpose, but it must do it in a particular way which reflects its role in the statutory scheme and that's the critical element that's missing in my submission from the Commission's approach to this question; that's what the Court of Appeal understood, and in my submission once the legislation is carefully examined and attention paid to where this particular decision fits in the statutory scheme, then that's where one ends up. And that

Tipping J Well just pause. You're then saying really your case substantially depends on a favourable answer to the first question, because if you don't get a favourable answer to that you're going to be in real difficulties aren't you in the second?

Goddard Both limbs of the argument depend critically on the question 'what is the purpose of thresholds'?

Tipping J Yes.

Goddard Yes.

Tipping J Exactly.

Goddard But it would be possible for the Court to agree with my submission on what purpose of threshold is but to find in my favour

Tipping J Theoretically possible.

Goddard But to find in my favour on either of the other limbs. Now

Tipping J But your fundamental point is that they've misunderstood the role of thresholds in this total regime?

Goddard Yes.

Tipping J Yes.

Goddard This submission, and I'll come back to this, echoes the question that Your Honour Justice McGrath asked of my friend earlier about the quote from *Padfield* about identifying the purpose of a power in the light of the statutory scheme and how that fits with purpose provisions, and my answer to that would be yes, every power must be exercised consistently with this broad statutory purpose identified in that purpose provision but it must also be exercised in a way which is consistent with the statutory scheme and the purpose for which that particular decision-maker is making that particular decision within the scheme.

McGrath J Well you're really saying that the, and I think this was the point I was driving at, the question, it's not just the specific purpose provision that is important here. It's the, if you like sub-purpose, in relation to a particular aspect of the scheme, the thresholds.

Goddard That's exactly right Sir, and of course that point was illustrated by *Padfield* itself because what one had there was a Minister who had a power to inquire into certain matters and some milk producers who

complained to the Minister and the Minister said no, look this would require a big change to the scheme. Your concerns should be dealt with within the standard committee mechanism, and what the House of Lords said was 'no the whole purpose of this ministerial inquiry power is to deal with the big issues, the hard issues, that can't otherwise be accommodated within the machinery of the scheme. So to decline to hold an inquiry because it's big, because it's hard, and because you know that the ordinary machinery will reject the proposal, is precisely to miss the point. So there

McGrath J In the end the question really is how wide is the discretion in relation to this first step of the scheme of fixing the initial threshold?

Goddard Yes, and the discretion like any discretion is confined by the purpose for which that discretion is conferred, and that's a much more specific question than the purpose of the Act as a whole. It's a sub-purpose to use Your Honour's

McGrath J I understand the point, yes.

Goddard Language, and it's a very helpful way of putting it. Now these two argument got conflated in the Court of Appeal with the result that the misdirection argument simply isn't discussed in the Court of Appeal's decision at all, despite being described by Justice Wild in the High Court as being at the forefront of Unison's argument and I had thought it was in the Court of Appeal as well, but I obviously muddled it up too much with the second outside the purpose

Tipping J Well it's probably if you use this rather illusive concept of not asking yourself the right question, you might with respect have muddied the water Mr Goddard. I mean I fully understand what you mean by that, but it's something that tends to be bandied around in a rather sort of illusive way, but I fully understand the point you're making, that they misunderstood the purpose of the theshhold.

Goddard Yes Your Honour, and it's often the case that when a decision-maker does something that is outside the statutory purpose, that results from having misunderstood; asked yourself the wrong question; set out to do sample other than the statutory purpose, but it can also be the case that a decision-maker asks itself the wrong question but nonetheless ends up somewhere on the continuum of permitted outcomes. A Judge can give a direction to a jury that is wrong in law but the jury may still come back with an answer that would have been open to it if properly directed. That's not good enough unless the proviso applies and it's clear the jury couldn't have done anything else if it had been properly directed.

Blanchard J Are we to apply the proviso here?

Goddard And that's the scope of discretion, yes.

Blanchard J I think we're going around in circles here.

Goddard I just want to be clear about

Blanchard J You're in danger of talking us into confusion too I think unless you actually go the point you're trying to make.

Goddard And that's precisely Your Honour what I propose now to do. Turning then to my road-map, the first point - thresholds are a screening or diagnostic tool. Now my submission in short, and I'm going to have to go through the legislation in a little bit of detail on this, is that the purpose of a threshold is to prepare a shortlist of candidates for control.

Tipping J Well the Court of Appeal used your short-list metaphor didn't they?

Goddard They did.

Tipping J And it's in the paragraph following the one that I drew attention to a few minutes ago and I personally regard that as problematical Mr Goddard so you'll have to do some work there.

Blanchard J And the question of whether it's a short-list or a long-list.

Goddard It doesn't matter whether it's short or long Your Honour, the point is that it should be of people who are candidates for control, so Justice Anderson asked in my submission a very important question when Your Honour asked 'as long as you catch some people but not others, haven't you screened', and staying with the job metaphor if I had a large number of applicants for a job - I wanted to employ someone – and I said to an HR Consultancy would you please screen the candidates for this job, I would expect to get a list, it might be very short, it might be a little bit longer, of people who had been selected for that list by reference to criteria which would ultimately be relevant to appointment to the job.

Anderson J Well the concept of screen is itself metaphorical

Goddard It is but it's a very important metaphor here Your Honour because in my submission it's exactly what the statute requires the thresholds to do and I'll go I think to the statute to illustrate that. If I could

Tipping J But shouldn't, oh no, well perhaps I'll resist the temptation to debate the point with you Mr Goddard at this stage. You just do as my brother the presiding Judge has said, let's go to the jugular.

Goddard Let's go to the jugular, let's go to the legislation because that's really what this is about.

Blanchard J We just can't avoid metaphors it seems.

Goddard I'm afraid that between Justice Tipping and myself the tendency to metaphor is a little extreme.

Tipping J It's a little extreme but I'll do my best Mr Goddard.

Anderson J They often add more confusion than enlightenment.

Goddard So turning then to Unison's authorities, volume 1, tab 1, the Commerce Act, the first part of the Act deals with machinery issues**,** part 2 deals with certain trade practices issues, part 3 with acquisitions, and where I want to begin is at part 4, controlled goods or services, which begins on page 49 of the Commerce Act, the numbers at the bottom of the page. Part 4 is the generic price control regime that applies to everything except now electricity line services. The electricity lines were carved out of part 4 when part 4A was introduced. Part 4 begins by prescribing when control may be imposed. If the goods and services are or will be supplied or acquired in a market in which competition is limited or is likely to be lessened, an it is necessary to desirable for those goods or services to be controlled either in the interests of acquirers or, and this is not so relevant here, in the interest of suppliers. So the idea is that price control can be imposed if there's a lack of competitive pressure and it would be in the interests of acquirers to do so, if you're talking about a market for supply of services which is the focus here. However is control imposed – s.43 provides that control is imposed by the making of an order in Council that's made on the recommendation of the Minister, the Minister of Commerce. The Minister must be satisfied that the good or services may be controlled under s.52; the general criteria in s.52 is satisfied, and that recommendation can be made by the Minister on his or her own initiative or following a report from the Commission. So there's a very broad discretion exercisable by the Minister; the significant policy element of it reflected by that level of decision-making and the fact that it's embodied in an order in Council when made. The advice of the Commission can be sought, be need not be sought. Section 54 is where the concept of thresholds was first introduced into the Commerce Act. It was introduced as the note shows underneath the section in May 2001 by the Commerce Amendment Act 2001, just a few months before part 4A was introduced, so it was just a few months apart from it, same Parliament, same Government, and this is where thresholds first turn up. And what s.54 says is that the Minister can ask the Commission to advise him or her on the thresholds that would assist him or her in assessing whether goods or

services should be controlled under s.52. So thresholds here are a test, a screening test, to be used by the Minister to decide, to help decide to be precise, whether goods or services should be controlled under s.52. Very plainly in my submission the purpose of thresholds here is to sift out for the assistance of the Minister, companies which should be controlled from companies which should not be controlled, and that hasn't been

Tipping J Isn't the focus here on goods and services rather than companies?

Goddard And it is in part 4A Your Honour. It's on goods or services supplied by large electricity lines businesses and in fact the control decision can relate to particular goods or services supplied by them. It's the same

Tipping J By a particular – so it can just be goods and services in generic terms but as supplied by X?

Goddard It can also under here and that had been done by Order in Council recently in respect of gas pipelines services supplied by Vector and PowerCo.

Tipping J Thank you that's alright.

Goddard There was the airport's inquiry before that which

Tipping J Well there's no need to

Goddard Yes, it can be either particular companies or it can be all suppliers of a particular class of goods or service. Just parenthetically it's inherently unlikely that there will be a lot of suppliers in a market where these competition concerns arise. See you're normally talking abut a particular

Tipping J Quite.

McGrath J There's no competition just by passing judgment?

Goddard Not enough to be comfortable with the competition or constrained prices and quality, in the way it occurs in competitive markets. So what one has here is this instrument, thresholds, made by the Commission which assist the Minister in assessing whether goods or services should be controlled under s.52. And this echoes the provisions, or anticipates the provision pathway 'the thresholds can be expressed in quantitative or qualitative terms'. There's a procedure 'if the Minister requires advice on thresholds it must be in writing and the advice must be published'; and a little further on in s.57 there's a requirement that 'before giving advice to the Minister on thresholds under s.54 or making a report under s.56, the Commission must publish its intention to do so; give an opportunity to interested

persons to express their views and have regard to those views'. Exactly the same as in part 4A before thresholds are made there.

McGrath J But there's some sort of natural justice process before the advice is given?

Goddard That's right Your Honour, just as there is before thresholds are made under part 4A, it's exactly the same. So here we have the Minister making a decision by reference to broad public interest considerations constrained only by the criteria in s.52. We have the ability for the Minister to seek advice on thresholds which assist in deciding whether or not goods or services should be controlled, and s.55 the effect of control being imposed – that applies where the control begins under part 4 or part 4A. You can only supply in accordance with an authorisation; failure to do so has a range of consequences both civil and criminal. It's an offence to supply other than in accordance with an authorisation and its provision for injunctive relief and for compensation. I won't go to those, but the fact that control can lead to criminal consequences as well as civil, is important when it comes to looking at relief questions and I'll come back to that. Section 56 deals with reports from the Commission to the Minister about controls. The Commission can report to the Minister on whether or not an Order in Council should be made, amended or revoked. Taking the Court to s.57, and then there are some more technical provisions. So that is the process for imposition of price control which is Minister-driven but assisted by the Commission and potentially by thresholds which screen in the sense of identifying companies that supply goods or services that should be controlled, and those that shouldn't. As my learned friend said in his written submissions, and there are helpful accounts in the High Court judgment and also the Court of Appeal. 'There was a concern that the threat of intervention under part 4 was not immediate or constraining enough in the context of lines businesses, and that led to the introduction of part 4A, following the inquiry to which my friend has referred. Part 4A has some interpretation provisions. It deals with who exercises jurisdiction; there's provision for transfer of responsibility to the Electricity Commission, but that hasn't happened yet, and that brings us through to subpart 1, controlled goods or services. Perhaps pausing here, subpart 1 was one of five subparts. Subpart 2, which began on page 67 of this copy of the Act concerned Transpower's pricing methodology. It's not relevant to this case and it's been repealed because the Electricity Commission's now responsible for that. Subpart 3 on information disclosure, my learned friend's taken Your Honours to that. That carried forward an information disclosure regime that had been in place for many years in respect of the electricity industry. Information disclosure was not a new thing in respect of this industry. It had been provided for in the Electricity Act and in regulations made under that Act for many years. This was a transfer of responsibility for the administration of that regime from the Ministry of Commerce to the Commerce Commission, not an

introduction of a new animal altogether. Subpart 4 dealt with asset valuations, and it's since been repealed because it was completed, recalibration of asset values of large electricity line owners. The idea was that lines businesses to which this part applied had to provide updated asset valuations and the Commission would go through those carefully and check that they were up to date, and that was required to be done as a matter of some urgency on a very tight timeframe, and then beginning at 57ZD there was a requirement that the Commission carry out a review of valuation methodologies for line business system fixed assets as soon as practicable. That same timing injunction as in subpart 1. So what one had here was an instruction from Parliament to the Commission to set thresholds under subpart 1 as soon as practicable to do asset recalibrations on a very tight timeframe and then also as soon as practicable look at whether existing asset valuation methodologies were appropriate. So first of all recalibrate the ODV valuations and then second, but still as soon as practicable, look at whether ODV is actually the best way of valuing these assets. And then in subpart 5, some general provisions. So the Commission was given a number of tasks in August 2001, and it's now I think probably helpful to go back and look at those. 57E purpose. 'the purpose of this subpart is to promote the efficient operation of markets related to electricity distribution and transmission services through targeted control', and I'll come back to what that means, 'for the long-term benefit of consumers by ensuring that suppliers', and then there are three specific objectives – 'are limited in their ability to extract excessive profits; and it's common ground between the parties, and that means profits greater than the firm's cost of capital, in the normal sense, not the dairy industry regulation sense. Context is everything Your Honour. To face strong incentives to improve efficiency and provide services at a quality that reflects consumer demands, and to share the benefits of efficiency gains with consumers, including through lower prices', and the Court's already asked my learned friend some questions about this which I think teased out some important elements of this. First there must be efficiency gains before they can be shared, and second, lower prices is just one means of sharing. Efficiency gains, it can also be through increased quality, and third, very importantly, lower prices here must mean, and the Commission accepts this in a number of points of its submissions, lower than would otherwise have been the case, not lower than on a particular date. In other words as with most analysis under the Commerce Act you're looking at a counter-factual going forward and comparing prices if this is achieved against where prices would have been. If it hadn't been not, against prices at a particular earlier date. The same is true of the substantial lessening of competition test for example. It's a lessening that would be absent the provision not less than on some date. So it's that same counter-factual. So that's the purpose of the subpart, and again just pausing here, it was held by the High Court and its common ground that control can only be imposed if the Commission is satisfied that those

concerns exist in respect of a particular company. So control should only be imposed if the company's earning excessive profits or is inefficient or is failing to share the benefit of efficiency gains with consumers. If that's not the case then the inquiry ends. If that is the case, if that concern exists, then the next question is, is control necessary to achieve these objectives to limit the ability to extract excessive profits; improve efficiency; share gains – so it's a two-fold test, and the Commission has reiterated that in a number of its documents published since. Section 57F and G are critical machinery provisions for understanding what thresholds are for. 57F provides that in respect of goods or services supplied by large electricity lines businesses it's the Commission, not the Minister that has power to impose control. So for every other good or service supplied in the New Zealand economy, a Ministerial decision implemented by Ordering Council is required with the political accountability that goes along with Ministerial decision-making, and the making of Orders in Council. In this industry the Commission is given the power, but the price tag for that, or if you like a better way of putting it, the discipline on that is a much more structured, much more confined discretion. It's not as broad as the Minister's public interest remit. And subsection 2 goes on to say that 'no Order in Council can be made under part 4 in respect of goods or services supplied by a large electricity lines business. So part 4A is the only constrain now.

McGrath J When you say more structured, is that another way of saying it's a more hands on function, but a continuing one in the continuation of it?

Goddard No, I think what I meant to say Your Honour is that Parliament has gone further in prescribing how this is to be done, the steps that are to be taken, the criteria that are to be applied. It hasn't left the Commission with the same broad discretion as the Minister has under part 4.

McGrath J Is that not really just simply a consequence of the light-handed nature of the discretion which is calling for if you like more active monitoring?

Goddard More active monitoring is one aspect of that, but there's also an important structural discipline in here in terms of announcing thresholds in advance and giving companies the opportunity to comply with them, and remain within the safe harbour that they provide and ensure they avoid control. There are no safe harbours under part 4, but under part 4A there is a safe harbour and it's achieved by the prior announcement of thresholds and the inability of the Commission to impose control on a company that stayed within the thresholds. And a Minister can't impose control on such companies under part 4 any more, so if you stay within the thresholds you are immune from price control, and that's critical. That's that safe harbour concept.

Tipping J But the threshold can be changed on you.

Goddard Following the statutory consultation process and consistent with the purpose of the legislation, yes. But my friend I think was conscience of this in saying that the Commission would be reluctant to tinker with them too much. You're not going to achieve long-run incentives for the sort of conduct you want to encourage under this part if the thresholds are not relatively stable.

McGrath J Well that might be so once a certain period's passed, but it's not necessarily so at the outset is it?

Goddard I think it's true at any stage that if there's an expectation of change in the thresholds that will effect the nature of the incentives they create, and if you want to create long-term incentives you need long-term staple thresholds.

McGrath J Yes, but does that apply, or at least apply significantly at the early stage when you're setting the scheme up, when you're setting the regime up?

Goddard Yes, in so much that the threshold serve two functions – screening and incentives. It's not suggested that thresholds are not intended to create incentives - to the contrary, and the existence of those incentives and whether they incentivise behaviour consistent with the purpose, or inconsistent with it is something that in Unison's submission the Commission must consider. But the weight given to that is a matter for the Commission and that might vary with time. So the Commission has power to declare control, but that's not an unstructured power. A number of steps must be followed, and the first is prescribed by 57G - the making of thresholds for declaration of control. There are a number of aspects of this provision that in my submission shed light on what thresholds are for, but perhaps the first to notice is the language 'thresholds for the declaration of control'. It occurs in the heading of the provision and it occurs in para.A. Although there's a tendency to just bandy around the term threshold, and I'm guilty of it myself, that threshold's for the declaration of control, and that suggests that when one crosses over the threshold, one is in the territory of control and

Tipping J Doesn't it rather equally suggest that if you don't cross the threshold you're not liable to control? I mean

Goddard It suggests both.

Tipping J It suggested both, but one can't be given prominence over the other can it?

Goddard No, because there

Tipping J I mean it serves those purposes equally.

Goddard They're the flipside of each other in a way.

Tipping J Yes.

Goddard Yes, absolutely Your Honour, and in my submission the thresholds the Commission's adopted, and particularly the initial thresholds don't serve either of those.

Tipping J Yes, I understand.

Goddard It's not a question of giving one more weight than the other. My submission is that neither is served by the initial thresholds in particular but also the revised.

Tipping J Well they do it in theory. You're saying they don't do it with enough efficiency or effect, that is to meaningfully do it?

Goddard I say that they do no more than sort into two groups selected by reference to criteria with absolutely not correlation on whether or not the s.57E concerns are present. That it's like screening for candidates for a job by throwing the papers up, letting them land in two piles, and interviewing the people whose papers land on the right.

Tipping J So it's really wholly arbitrary you're saying?

Goddard It's wholly unconnected with

Tipping J Well wholly arbitrary if it can be an analogue with throwing a pile of paper in the air and seeing where the two piles end up – wholly arbitrary. Is that what you're saying Mr Goddard?

Goddard In relation to the initial thresholds, yes.

Tipping J You put it that hard?

Goddard Yes.

Tipping J Alright.

Goddard I don't need to get that far.

Tipping J No, no, well I don't know what you need or what you don't, I just want to know what you're saying, but it's wholly arbitrary.

Goddard Yes, so far as whether breach indicates that the s.57E concerns a present or not, wholly arbitrary. The fact of an increase in nominal price tells you exactly nothing.

Anderson J It might be an indication that you're altering the price levels for some reason.

Goddard Yes, plainly since you've

Anderson J And the reason is likely to be because you either want greater profits or because you're not efficient. That's what springs to mind.

Goddard No Sir the phenomenon of inflation reflects the fact that costs, import costs for firms increase and as a result their output costs will normally increase. Nominal prices do not stay constant in workably competitive markets. So to test for changes in nominal price tells you nothing at all about increased profits or reduced efficiency. It's just as likely to be the result of increased import costs or investment to produce greater quality

Anderson J Well given that, it doesn't mean though that it's not even worth a look is the price alternation, it's not even worth a look because it could mean anything.

Goddard Yes Your Honour.

Tipping J It's as bad as that?

Goddard Yes.

Tipping J In other words it's hair-brained?

Goddard If you're trying to test for the presence of the s.57E concerns, if that's what you're trying to do, it would be hair-brained. That wasn't what the Commission was trying to do. The Commission

Tipping J But from the point of view of any possible link with 57E, it's hair-brained?

Goddard Yes.

Tipping J Yes, I just wanted to understand how your client wishes you

Goddard Yes absolutely.

Blanchard J Which is funny that nobody said that at the time.

Goddard No well Unison said that at the time.

Blanchard J Oh come on, Unison was saying a whole lot of things, not always consistently but I'm not sure that I read them as saying anything like that.

Goddard Unison was faced with the difficult position that it considered that the Commission was asking itself the wrong question and Mr Sutherland's affidavit includes a letter sent in May 2003 before the threshold decision was issued. The first threshold decision was issued on 6th June 2003. My learned friend took the Court to a media release in March saying what would be done but no reasons were released at that stage and the Gazette notice wasn't made at that stage. The reasons were released on 6th June 2003 and that's when the Gazette notice was made. Before that happened Unison wrote a letter, and in fact that wasn't included in the bundle by oversight despite being referred to in the Court of Appeal, but I do have copies for the Court which outline precisely this concern, and that was reiterated in June.

Blanchard J Well it's not surprising we haven't seen it if you didn't include it in the bundle.

Goddard No and I apologise for that Your Honour. It was referred to in Mr Sutherland's affidavit, which is of course in the bundle. But that was sent before the initial threshold decision was formally made by Gazette notice. The Commission didn't accept that criticism and as a result it was conducting a process but it was asking a different question. Unison can hardly be criticised for engaging on the terms set by the Commission for responding to the questions it was asking and playing on its rules in circumstances where the Commission was saying no, we don't agree with this.

Tipping J Is there any evidence in your client's evidence or anywhere for that matter, primarily I suppose Mr Sundakov, that puts it as high as this idea of all this methodology when related to s.57E is hair-brained? And where do we find that?

Blanchard J Well first should we look at this letter?

Tipping J But I thought, sorry

Goddard You will see in para.2

Tipping J Of what?

Goddard Of the letter of 29th May. 'Based on the company's notional revenue, companies that have increased average prices will breach the threshold and

maybe subject to investigation. Price path assessment is not tailored to particular companies in any way. It does not take into account the level of profits earned by a company or the efficiency. It does take into account implicit discounts and then the result is' and it goes through

Anderson J I don't know whether I've missed something Mr Goddard, but just briefly what do your clients say is the statutory purpose of the threshold?

Goddard It's a first screening, a first short-listing for companies that raise the s.57E concerns.

Anderson J If it goes so far as to say from passes the threshold, presumptively one is going to be declared under control unless they can persuade the Commission otherwise pursuant to 57I.

Goddard That there are some grounds for considering that the company is a suitable candidate for control.

Anderson J If you look at the section, and I'm just trying to see what the difference in emphasis is between you and the Commission, but if you look at 57H, it would seem that if a threshold was crossed the Commerce Commission has to make a determination whether or not, and if it decides not to, even perhaps through informal discussion, has to publish the reasons why not.

Goddard Yes and in my submission that's actually a very helpful indication that if the outcome is a control declaration there's no positive obligation to give reasons for that because you've breached the threshold and it's not a surprising outcome. What the Commission is required to give reasons for is not imposing control even though the Company breached the threshold.

Anderson J So you take a hypothetical case of the thresholds breached and the Commerce Commission looks into it and says well yes, subject to whatever comes out of 57I we're going to declare control.

Goddard And at that point well yes. So in my submission precisely what happens under 57H is that there's an assessment, including the process in 57I which results either in a control declaration or in the Commission saying notwithstanding the breach of a threshold we have concluded that this company ought not to be controlled for these reasons. The only reason one needs to say that and publish those reasons is because the fact of breaching the threshold suggests that there are grounds for control. Now I'm not putting it as high as prima facie Your Honour, but it's a bit like perhaps the test for an interim injunction say. There's a serious case, a serious issue to be tested by inquiry as to whether those concerns are present. The threshold breach should tell the Commission that there is a serious issue to be inquired into as to whether the s.57E concerns are present.

Anderson J So the difference between you and Mr Dobson seems to be the extent of the hard look?

Goddard No Your Honour because Mr Dobson doesn't say that the thresholds need to shed any light at all on the question of whether the s.57E concerns are present.

Anderson J It's a matter of degree it seems. One there is that the process throws up companies that really ought to be looked at. The other is the process, if it were an appropriate process, throws up companies that are likely to be declared under control, unless there's some reason why not.

Goddard It goes a little bit further than that Sir because Unison's submission is that a company that ought to be looked at is one in respect of which there is some evidence, some indication, that the s.57E concerns are present. My friend rejects that. My friend says this is not meant to be a diagnostic tool in respect of those concerns. It's enough to throw someone up for a look because it's not behaving in the way which the thresholds require, and that's quite a different proposition.

McGrath J Are we now back with your client's letter of the 29th May?

Goddard I don't want, sorry, yes Sir.

McGrath J I was going to ask you a question about it if you've finished replying to Justice Anderson.

Goddard I have Sir, yes.

McGrath J Could you just help me again with this notion that does seem to feature prominently in Unison's case of implicit discounts. Does this basically mean that you've been caught with your prices too low when price control comes in?

Goddard Yes. My friend emphasised the large number of lines businesses in New Zealand and the very great differences in size. Another complicating factor in terms of regulation of lines businesses in New Zealand is the very different ownership structures that existed, with some being community owned through Trusts and rather than earning commercial dividends and then paying them back to owners, consumer owners, through the Trust, simply charging lower prices that included an implicit dividend to consumers, and Hawke's Bay Network as Unison then was, had for a long time been following that course. There's a lot of evidence and disagreement between the parties over whether it departed from the course

and when and to what extent, especially following the acquisition of part of the United Network's assets.

McGrath J I'm just wanting an explanation of the term and I think you've come to it. What you're basically saying is that within a co-operative type structure there was in some instances no wish to make profit or significant profits and prices were lowered and that's called implicit discount.

Goddard Yes Sir, and my friend took the Court to *Meyrick and Associates* table which showed returns on investment as low as 1.3%, which no one would suggest was a commercial rate of return. That reflects implicit discounts.

McGrath J Yes, thank you.

Goddard Now I don't want to go through this paper in detail except this letter, sorry just to note that it was sent, that it raised essentially the same concerns that are being raised with the Court now

McGrath J You raised these.

Blanchard J You raised it. It's not surprising it raised the same concerns.

Goddard It's appropriate for companies to seek advice on some of these things

Blanchard J Absolutely and I'm not critical of that.

Goddard But this is not a new issue, and meanwhile in parallel, Unison had to engage with the Commission on an inquiry where it was asking very different questions, and it was entirely proper for Unison to participate in that rather than simply give up, throw its hands in the air and say 'oh you want to ask a different from us, very well we shan't play'. It's not realistic to expect someone to do that, so it's all very well for my friend to suggest that when Unison rolled its sleeves up and got its hands dirty trying to engage with the Commission on its territory it was saying things inconsistent with what is now being said. Of course that's the case because Unison was trying to respond to a line of inquiry, to a line of endeavour which it thought was wrong in law, but nonetheless to engage constructively with it lest it be wrong,

Tipping J Four and five are the crucial paragraphs in this letter and it seems to me that the essence of the complaint is last sentence of 5, insofar as it's, and I'm not suggesting one should dissect this, but that really is the high-water mark isn't it of your client's complaint? The proposed threshold has not addressed either excessive profits or efficiency so it's clearly at odds.

Goddard Yes.

Tipping J If one needs to see it stated in the simplest of possible terms that's it.

Goddard Yes, and Unison is not alone in considering that that's the consequence. My friend referred to the submissions from NERA, the Economic Consultant's assisting PowerCo, who advocated what effectively became the Commission's approach on this issue and an initial price path of constant nominal prices and the CPI-X, and there was a fascinating exchange between Ms Bates QC, member of the Commission, and the NERA expert about what a price path would do which in my submission illustrates that sometimes lawyers can be asking the right question when economists all around them are off doing something other than that which the legislation has prescribed.

Anderson J We often think that.

Goddard And really my whole case Sir is not built on economic evidence as my friend suggested, it's saying this is actually a question of statutory interpretation where the wrong question got asked because some economists thought there was a better way to do this, and really Ms Bates at an early stage was asking the right question and the Commission lost sight of it and it disappeared.

Tipping J Where do we find this Mr Goddard?

Goddard I'd like to take the Court to that because I think it's helpful. It's in volume 4 of the case on appeal, under tab 24. There are some extracts from the transcript of the Commission's conference in 2002 at an early stage of the threshold design process and the passage that I want to take the Court to begins on page 585 of the case on appeal. Dr Houston and Dr Berry of PowerCo have been making some submissions and then Ms Bates comes in at line 30, 'can I just ask a question she says, what you're proposing is a price path with PO, I think that means no PO, not adjustment in existing prices, so no PO, and X0 at the moment'? Dr Berry 'correct'. Ms Bates, 'so I'm just having difficulty with how that's going to operate as an assessment tool for finding the companies that have excess profits at the moment. I'm just wondering if you could give me a bit of assistance that maybe I've missed the point, but I'm having a bit of difficulty seeing how that's going to operate'. Dr Berry says 'at the end of the day there is a pragmatism about starting out with something, is a starting point X is equally so', and Ms Bates being a lawyer knows when her question hasn't been answered and presses a further 'yes the question was, how is that going to help us to make an assessment? Because I see that the thresholds as being a sort of tool for assessing how further down do you look. How is it going to help us to assess at the moment which companies are earning excessive profits? If I've missed the point I'd like someone to actually tell

me'. What Dr Houston, in many ways the author of this proposal says is 'I don't think you've missed the point, in the sense that I think it's been clear from the discussion this morning that taking existing prices as given is something which is a pragmatic approach, but that it's not an approach which could address the existence of an accumulated position where there were excess profits, however you may wish to define them. The important message is that you should never wish to aim to address the possibility there may be excess profits, in the existing prices, but what you cannot hope to do that by October this year in a way which is respectful of due process, natural justice and all the things that will inevitably come to the fore in going down that road, and on which economists are experts. You need more time and you need a lot of time'. Ms Bates sticks to her question, 'at what point does it become useful for us as an assessment tool'. Dr Houston, 'does what become useful'? Ms Bates, 'what you've proposed, the regime you've proposed'. Dr Houston, 'well, what it can do is limit your ability to earn excess profits over time, but I don't think we can pretend that it provides a basis for assessing the excess profits that exist in prices today. It can't do that. We would be wrong to pretend that it could'. Ms Bates, 'talking about timeframes before, pretty non-specific, but have you given that any more thought'? Dr Houston, 'well so if you want or feel that you must address the extent to which excess profits exist today, then you need a basis other than existing PO to do that, and you need a lot and I think you should work on an assumption of two years to do that for any individual case'. Dr Houston next answer, 'the question of asset valuation for example is fundamental to the determination or assessment of whether excess profits exist'. Plainly that's right, you can only work out whether the profits are excess or not if you know what the asset value is because then you can start looking at what should be earned as a return on that. In my submission that's why Parliament told the Commission to get its skates on and do an asset re-valuation as soon as practicable in parallel with the setting of thresholds. Dr Houston, 'asset valuation is an issue of significant controversy in the airports context. It's something the Commission has started to address in electricity but is at a very very early stage. I don't see how you can hope to make a meaningful assessment of excess profits without having come to a landing on asset valuation and I think experience suggest that that's not going to be a five minute task'. Chair, she one of considerable importance. 'I hear what you say'. Dr Houston, 'so I don't think we're saying you shouldn't do it but I think what we're saying is you can't do it by the objective of October this year'. And over the page Ms Bates has another question. It's a tenacious cross-examination of this economist. 'Just one more question about assessing efficiencies'. So moving on from excess profits to efficiencies, the next limb of the purpose statement. She is a lawyer, she understands this is central to this exercise. 'This may take a longer time too, but can you really get a handle on efficiencies without looking at costs'? Dr Houston, 'no, of course not. There's no way known to, there's no

regulatory regime anywhere in the world or any efficiency estimate I've ever seen or heard of that doesn't start with costs, because if you don't look at costs you know what have you got'? Ms Bates, 'Yeah, I'm thinking back to the legislation itself which promotion of efficient operation of markets, albeit for the long-term benefits of consumers, is the overriding objective. So, we've got to have some way of assessing efficiency'. Dr Houston, 'Well I don't necessarily see that following in the sense that you need to come up with a scheme that directs constructive positive incentives for efficiency' otherwise you encourage it. You don't have to test for inefficiency, you can just encourage people to get efficient. 'You can't determine directly the efficiency of the business. All that you can do is put in place arrangements that other people will take and respond to either resulting in improvements to or deteriorations in the efficiency', and so on. So that's actually Dr Houston very frankly acknowledging that if you have the sort of price path that he was advocating and that the Commission adopted, then you had no way of testing for excess profits, the presence of those, no way of testing for inefficiency – it simply doesn't do it. And Mr Sundakov has said the same thing. He's said that a change in price tells you nothing at all, I think is the language from memory, about whether a firm's earning excess profits and it tells you nothing at all about whether it's efficient or inefficient. Dr Houston agrees that the Commission has never sought to argue the contrary, because it can't be argued.

Blanchard J Who is Dr Houston?

Goddard He's a senior international economist from NERA who was at the Conference on behalf of PowerCo, not Unison, and his thinking was very influential if one works through the whole process on what the Commission ultimately did. He was advocating what the Commission did.

Tipping J If you are restraining price are you not indirectly restraining access profits and creating incentives?

Goddard If you restrain price. If you say you can't change your prices, you're restraining profits, but not necessarily excess profits. There's no diagnosis. Profits are not a bad thing

Tipping J No, no.

Goddard And if you just hold price constant, what you are doing is deterring profits, not excess profits, and yet that's what the statute requires. Perhaps a good way of illustrating that is

Tipping J Just pause will you. You're saying hold prices restrains profit not necessarily excessive profit?

Goddard Take the example of the community-owned lines business that was earning 1.3%. Imposing the initial threshold on that company constrained it from increasing its profits, but not from earning excess profits. In fact it constrained it from earning normal profits which was desirable.

Tipping J I hear what you say in that respect, but what about incentives towards efficiency?

Goddard Efficiency requires appropriate investment in both maintenance and in capital assets, and it is no more likely to be efficient to hold prices constant than to increase them to fund some of those investments. There is no way of saying, and again the Commission has never suggested otherwise, that holding prices constant is more efficient than increasing them, it is just as likely.

Tipping J So there's no necessary correlation between price and efficiency? Is that your client's position, put in perhaps over-simplified terms?

Goddard That's a little bit simple. For any limit on price

Tipping J Surely if I'm constrained in what I can charge, that incentivises me - awful word - to become more efficient.

Goddard No Sir, because product efficiency and becoming more efficient might require you to invest. If I want to become more efficient as a lawyer I might need to get a new computer rather than the horrible old slow one I've currently got. In order to do that, in order to become more productively efficient I need more capital to buy that computer.

Tipping J That may be one way of becoming more efficient; it may not be the only way.

Goddard No.

Tipping J I may have to work a bit harder over the long coffee break.

Goddard There are lots of ways of becoming more efficient. The thing is that not increasing prices encourages some but discourages others and there's no way of knowing which are more important, so if you're talking about encouraging efficiency, holding prices flat is indeterminate. There's absolute no correlation. Dr Houston said that. He's right, you can't tell anything about efficiency just looking at price changes.

Tipping J So instead of my earlier proposition, if I amended it to you saying 'no necessary correlation between holding prices and efficiency'. It's not between price and efficiency but between holding price and efficiency

Goddard That's a much better way of putting it Sir. I'm completely happy with that.

Tipping J Yes.

Goddard There's no correlation at all, as a matter of logic or economics between holding constant and efficiency.

McGrath J What if you knew that in a particular situation there was no immediate need for investment by any company and you were just contemplating holding that they would be required to hold prices for a short time?

Goddard If one had carried out that inquiry, asked that question and formed that view, then yes conceivably that could be the case. The thing is here the Commission didn't do that.

McGrath J But it's hypothetical you say?

Goddard It's hypothetical.

Blanchard J It's 4 o'clock. How are we going in terms of the progress of the case?

Goddard Well rather slowly I think Sir. I've been on my feet for an hour and I clearly have some way to go to satisfy the Court that the Court of Appeal was on sound ground in respect of the initial threshold, so I do need to take my time on that. I've got a little bit more to say about the legislation

Blanchard J Yes.

Goddard And then I want to come back to this point that there is no link at all between holding prices constant in any of the s.57E concerns, both in my submissions and some of the evidence on that, and then I want to go through very carefully what the Commission actually did, because that's critical, both to the mis-direction question and to whether it achieved the purposes, and a large part of my friend's submissions were an interesting ex post justification of how the Commission might have got to where it did but don't actually reflect the question it asked itself and I want to take the Court through that.

Tipping J Is it inherent, just before we break Mr Goddard, that in your argument the CPI-X approach was wholly inapt to the task it was being asked to perform?

Goddard No, because in my submission you can't sensibly say that the approach is or isn't apt. Everything turns on its parameters

Tipping J But it's directed, I'm sorry, it's directed fundamentally to price isn't it?

Goddard Yes.

Tipping J And you're saying that a mechanism that concentrates on price doesn't perform the functions that it's supposed to perform.

Goddard Unless it is sensitive to starting points in terms of profitability and efficiency

Tipping J So you bring the PO factor into the equation?

Goddard What I say is if you're going to use a price path you have to look at the PO issue, but that's not the only way of doing this, and that's the other thing I want to be very clear about is that there are many

Tipping J Alright, well I don't want, I just

Goddard Ways the Commission could have set valid thresholds. Mr Sundakov wasn't suggesting the only way, he was simply giving one illustration. But there are others. I identified some in the Court of Appeal and I'll take the Court to those tomorrow, but if one is going to use a price path then in my submission it could only meet the statutory purpose if it was adjusted to reflect initial conditions of profitability and efficiency, but there are other ways of skinning that cat, which the Commission elected not to pursue.

Tipping J But on this particular methodology it is only appropriate if the PO factor is right?

Goddard Yes, if there is some adjustment to reflect initial profitability and efficiency, so it's not helpful to say CPI-X is or is not a valid form, everything turns on how you do it.

Tipping J Okay, thank you, that's helpful.

Goddard I should also say that I don't accept that hold nominal prices constant is in any meaningful sense a CPI-X threshold. It's a price path but to describe it as CPI-X is like describing it as the Commission Chair's age, minus the Commission Chair's age, it's just hold nominal prices constant.

Tipping J Well that's the effect but the methodology happens to self-define.

Goddard No, but perhaps I should come back

Tipping J We'll leave that Mr Goddard.

Blanchard J Alright Mr Goddard, that's helpful. We'll resume again tomorrow at 10am.

4.04pm Court Adjourned

20 June 2007

10.02am Court Resumed

Blanchard J Yes Mr Goddard

Goddard Your Honour yesterday afternoon I took the Court to some of the key provisions of the legislation and with a few digressions went through the basic legislative scheme; the thresholds under part 4 which are plainly a diagnostic tool to help the Minister work out whether concerns about absence of competition had disadvantage to purchases are present, and then the introduction a few months later, in part 4A of the same mechanism, with some provisions that are essentially parallel. Same sort of consultation provisions; same provisions they can be quantitative or qualitative; commissioned to set thresholds described as a means of targeted control, and I'll come back to that word 'targeted', thresholds for the declaration of control, and was asked some questions by the Court which I think ended up in the position that the threshold can be looked at either way. It's not helpful to talk about it as a threshold screening in or screening out - that it's a threshold for the declaration of control. The idea should be that if you cross the threshold there is some evidence of presence of the s.57E concerns, enough to raise a serious issue about whether control is appropriate or not enough to require the inquiry to be conducted under 57H. I took the Court briefly to that. An obligation to enquire into each business that breaches. No ability to enquire if they don't. So you don't breach the thresholds you're protected from price control, and of obligation to enquire to determine whether or not to control the goods or services supplied by the business, and either make a control direct threshold or decide not to and explain in the gazette why you're not. You have to publish reasons for not imposing control after a threshold breach under 57HD - there's no similar obligation expressly set up in the statute to explain why you're making it because the existence of a threshold breach indicates in this statutory scheme of itself that there's a

serious concern, a serious issue to be inquired into as to whether the s.57E concerns excessive profits; inefficiency; failure to share efficiency gains with consumers, are present. I didn't take through but my learned friend Mr Dobson did, so I needn't I think repeat this. 57I, the process to be followed before a declaration is made. The effective declaration of control operates as if it were an Order in Council under part 4. The prioritisation provision, 57K, perhaps just worth noticing in 57K, ss.2, the various factors the Commission is permitted to have regard to, encouraged to have regard to by the statute, includes size, recent performance, including prices charged, extent of excess profits, quality of information, and the extent of breach. And again the extent of breach suggests that that might tell you something useful about whether or not there is a concern. And the maximum of five years for control under 57L. Authorisations and undertakings my friend took the Court to, that's in 57M, the requirement that when imposing control the Commission should have regard not to the usual purpose statement under part 5 but rather to the purpose of this part, subpart s.57E. So what one has is an instrument threshold, which is a diagnostic tool under part 4, and in my submission equally, a diagnostic tool under part 4A. The idea is that one is testing in some way for presence of the concerns that would justify imposition of control. And what that involves I'll come to in just a moment. If those concerns are present, an inquiry is held and if those concerns are borne out by the inquiry, and if there's no other way of achieving the subpart if it's necessary to do so in order to achieve its purpose, control in turn is imposed. It's helpful to look at what Parliament envisaged in establishing this regime and the most relevant extract from Hansard is in volume 3 of Unison's authorities. It's a hideous fluorescent yellow and it's under tab 40. The only discussion of this issue in the course of the legislative history and in depth occurs in the committee stage of what was the *Electricity Industry Bill* subsequently divided into amendments to the Electricity Act, the Commerce Act and other matters, and the relevant passage begins on page 10410 of Hansard, the number is on the top lefthand page. The Committee were taking the Bill in parts and this is part 2, *Amendments to the Commerce Act 1986* - this is what became part 4A, and there's some comments from Pansy Wong and then the Court will see that Hon. Pete Hodgson, Ministry of Energy, the Minister responsible for this legislation in the Chair, makes a short three-line comment; Dr Nick Smith, and then we start to get into the substance. The Minister outlines the history of this legislation. Patsy Wong indicating that back in 1999 the Labour Party pulled the plug on electricity legislation but didn't go far enough. The Commerce Commission to do the regulation by Christmas of that year. Government back then in a blind panic says the Minister. There's some politics in this speech as well as some helpful exposition. Neither is a case for ensuring monopoly providers get a form of regulation, form of price control. However what was going on then was that Mr Bradford was determined about several matters. First he was determined that all the

lines companies needed to be regulated without evidence. Secondly he was determined that only the lines companies needed regular true intervention. That gentleman as that stage was going to be very heavy-handed on one part of the electricity sector. There was not going to be regulation to ensure the proper passage of consumers from one electricity retailer to another for example. So we brought in the Commerce Commission staff and asked if they could do it. They said to the Select Committee 'well yes we think we can do it'. Then we asked 'how many people have you got on board now to do it'? They said 'two'. Two people were going to regulate the lines companies of New Zealand and they were going to get their preliminary report out something like seven weeks after the passage of the legislation. At that stage we realised we were dealing with a Minister wildly out of control. I only read that out because of what comes next. However there was a case for ensuring that if the legislation was delayed, monopoly rents would not be created the lines companies putting up their prices in the meantime. So guess what, we rang them and said 'will you undertake publicly to have a price freeze'? They said 'yes'. We asked ' will you undertake it to make it a nominal price freeze so that it is actually a slight decrease when the CPI is taken into account'? They said 'yes', and they did it. That needs to be acknowledged publicly. The lines companies knowing that they were facing ridiculous legislation from the then Minister, said they would undertake a nominal price freeze. Just pausing there, my friend much of the fact that lines charges hadn't changed increased much in the period 1999

Tipping J I've never been fond of Hansard's reference, but really where are we going on this Mr Goddard?

Goddard Let me take you to the next paragraph Your Honour.

Tipping J Are we yet to reach the punch line?

Goddard Yes.

Tipping J Good.

Goddard Now we have another Government and after a little more consideration we say that to try to fix up this mess we need to regulate the lines companies that are out of control if there are any and not those that are not out of control. We need to pay attention to the lines companies according to a set of criteria. And that's really the punch line. The punch line was that the whole purpose of this was to regulate the lines companies that are out of control if there are any and not those that are not out of control, and by out of control, it's apparent that the Minister meant earning excess profits operating inefficiently. And note also the 'if there are any', Government, Parliament's mind was open on the question about whether there were any

that were out of control. A process needed to be set up to establish that. And then that's why and at the foot of that page there is a reference to 'targeted control'. So a targeted control regime at the companies that are out of control, and in my submission that's exactly what thresholds are intended to do to identify the companies that may be out of control to help target the control at those that are out of control, i.e., those who are earning excess profits; those that are inefficient. It's meant to narrow the range within which the Commission focuses its regulatory activities. Now I want to turn to the critical question of whether a nominal price increase tells you anything at all about whether a company is out of control. Whether it tells you anything at all about whether any of the s.57E concerns are present.

Blanchard J Can I ask you where you are in relation to your outline of oral submissions because so far I haven't been able to see that you're following it at all, and I wondered why we've been given it?

Goddard No I'm not. I prepared that before my learned friend's submissions and before the questions from the Court. What I'm now trying to do Sir is to really deal with my para.1 in much more detail than I'd expected to. I'm stepping through the requirements of the legislation in terms of targeting; in terms of what thresholds are meant to do; and I'm now going to move on to the question of, which is really para.2, did the Commission ask itself the right question, and in order to understand that it's critically important to understand whether a price change tells one anything at all about the existence of those concerns.

Blanchard J Well that may more helpfully go to your second question.

Goddard Yes I'm moving on to 2 now.

Blanchard J Good.

Goddard I do need to deal with this very carefully though because it is a fundamental point and it's one that the Court of Appeal appreciated, that's why for example Justice O'Regan said these aren't thresholds at all, the initial thresholds, because looking at a price change doesn't tell you anything about those. The evidence is all one-way on this. There is evidence that they tell you nothing and no evidence to the contrary and that's consistent with what Dr Houston was saying in the passage I took the Court to.

Anderson J I would be helped to understand the detail of your argument Mr Goddard if you could assist me in this way. Briefly what question do you say the Commission asked itself, and briefly what question shouldn't have asked itself?

Goddard What it asked itself was unclear in relation to the initial threshold. It's very difficult to discern what question it was asking itself and I'll take the Court to that decision. By the time the Court came to the revised thresholds it's very clear that the question it was asking itself was how do we design a threshold regime that creates incentives for conduct consistent with s.57E? And that's pretty much explicit in the decision and I'll take the Court to that. So the Commission was asking itself how do we design a threshold regime that creates incentives for conduct consistent with s.57E? What I say the Commission should have asked itself is that it should have paused to notice that thresholds did two things – screen and create incentives, and it should have said first well the proposed threshold assist us to identify companies that are candidates for control in the sense that there is a real risk that the s.57E concerns are present. It's like a Doctor looking for illness. You look for symptoms of the disease.

Anderson J This is fundamentally different from the proposition that they asked themselves the right question but answered it wrongly.

Goddard Yes, I'm not saying that at all, and I wouldn't want to be understood when I responded to Justice Tipping to say that it would be hair-brained to do this, that the Commission behaved in a hair-brained way. They didn't, they just did the wrong thing. So they gave a perfectly logical answer to the wrong question, but as a matter of law it was the wrong question. If that had been the answer proffered to the right question then it would have been hair-brained.

Anderson J Thank you.

Goddard So that was one of the questions it should have asked itself. The other question it should have asked itself is what incentives are created by the proposed threshold and are those consistent with the s.57E purpose? And in respect of the initial thresholds I say they didn't ask that either. So those are two questions that I say they had to ask to do their job because they're the two questions that go to the heart of what thresholds were meant to do. Just on that question of the distinction between what Unison's say the question was, and what the Commission actually did, para.76 of my learned friend's submissions probably captures that pretty helpfully in one place. My friend begins by saying 'Unison criticises the Commission for not requiring the thresholds to operate as a diagnostic tool for existing excess profits and inefficiency. That's right, we do. We say it had to be a diagnostic tool, which shed some light on the question of whether the company was earning excess profits - some light on whether it was inefficient. That to adopt a test that had no correlation to those concerns was inconsistent with what thresholds were for. About two-thirds of the way down the page there's a sentence that says 'the thresholds

nevertheless select businesses for closer attention because both initial thresholds and the revised thresholds screen for those businesses that do not respond to the incentives for efficient behaviour provided by the thresholds. Now if I could just ask the Court to put the word 'efficient' in square brackets, because I'll need to come back to that, this is what the Commission set out to do and this is the sense in which the Commission says the thresholds screen. They select businesses for closer attention – that's what the statute requires if you breach the threshold – because they screen for those businesses that do not respond to the incentives for behaviour provided by the thresholds, and of course that's right. That would be true of any threshold. The threshold says we're looking for this thing. If you behave in a way that doesn't throw up that indicator you won't be caught. If you behave in a way that does, you will. So any threshold will screen in this sense. It will catch; it will single out the businesses that don't respond to the incentives it creates. If the threshold said you must increase your prices by at least 50% each year, it would screen for the companies that didn't respond to that incentive. That's a silly example but it illustrates the point I'm making. The Commission says the incentives were efficient and therefore it was good enough to be testing for whether the behaviour of lines companies responded to those incentives, and in my submission that misconceives what thresholds were meant to be doing because they should have been testing for the presence of the concerns. It's not enough that someone was behaving badly, but gradually getting better, even if that's what they were testing for, but moreover in respect of the initial thresholds, as I'll go on to show, both as a matter of logic and on the evidence, in fact responding to those incentives was not efficient for the majority of companies; it was not consistent with the purpose statement. For many companies responding to the incentives created by the initial threshold would be contrary to the s.57E purpose.

Tipping J Are you really saying Mr Goddard that the thresholds were not capable of contributing to this diagnostic exercise?

Goddard Yes.

Tipping J That's the submission in a nutshell and accordingly they were unlawful as not being within the statutory purview?

Goddard Yes. And that's what the Court of Appeal accepted. I also say that that came about because the Commission misunderstood what it was trying to do, and asked itself the wrong question.

Tipping J Well it probably doesn't matter. If they're not capable of doing it, then it doesn't really matter whether they misunderstood or not

Goddard Exactly.

Tipping J They are just simply outside the parameters of the legislative mandate.

Goddard Exactly Sir, and that's why Justice O'Regan said in para.92 of the Court of Appeal decision, 'these were not thresholds'. With respect to the majority I don't think that the comment about bluntness to which you took my friend later really captured Unison's submission or the essence of the concern that emerged in argument in the Court of Appeal and it was much more neatly captured by Justice O'Regan in that one paragraph, para.92, where he said 'these just weren't thresholds'.

Blanchard J Was he speaking of both thresholds?

Goddard No, the initial ones.

Blanchard J Yes.

McGrath J But your point really is that it is a threshold, it's just a threshold that has nothing to do with the purpose of the Act. That's why you're focusing on this sentence two-thirds of the way down 76 isn't it? You agree with the statement so far as it goes, then you're saying it's a statement of the obvious, but while it might be a threshold, it has nothing to do with the purpose of the Act.

Goddard That's exactly right Sir. I agree with it, minus that word 'efficient' I should say.

McGrath J Yes.

Goddard Yes, but I say yes that's true but it's nothing to do with what thresholds were meant to do under the Act. And I'm going to explain that in a couple of ways by reference both to logic and to evidence. A helpful starting point I think may be the graphs that my learned friend took the Court to in volume 7 of the case on appeal, under tab 39. These are the Commission's graphs. My friend referred to the fact that there some of it we prepared and although ours have the enormous advantage of actually being to scale, I think it might simpler to stick with his. So that's under tab 39, and if I could take the Court first of all to page 1097, the fourth of the graphs. As my friend explained, this illustrates not to scale the position of the best performing companies. A group which on the revised threshold assessment included three companies who were all very efficient and had below average profitability, and as my learned friend quite rightly said, those firms that were down following that red line that were charging prices, and I see the arrow at the beginning of the average price when part 4A enacted, prices down there much lower than they should have been.

They should have been up at that green line, and if you imagine taking that back all the way you can see that there was still a significant gap between the green line and the red - so they were charging too little and as my friend said quite rightly, that's just as much of a concern in terms of the regulatory purpose of the legislation as charging too much, and they should be encouraged to increase their prices, that's what my friend said. Now I want to ask two questions about this group of companies and I'll ask the Court to just reflect on the answers to these. First of all suppose these companies, the ones that are charging prices down on the red line, increase their prices, does that suggest that the s.57E concerns are present in respect of that company. Plainly it doesn't. To the contrary by increasing their prices, they're addressing those concerns. They aren't making them go away but it's a step in the right direction, so an increase in price by these companies does not tell us that there is a 57E concern in respect of these.

Tipping J But that will become only too apparent won't it when the specific company is looked at the post-breach stage?

Goddard After a considerable amount of work that may become apparent but meanwhile you've put that company which shouldn't have increased its prices to a huge amount of extra expense and cost and the Commission to that. The other problem, and it's a more acute, is the incentives created both by the initial threshold but also the revised one. You've got the company sitting down on that bottom red line from 2001 through 2003 and along comes the initial price path threshold which says keep your nominal constant. Now if the company responds to the incentive created by that threshold, what will it do? It will hold its nominal prices constant, and there are very strong incentives to do that because a threshold breach is expensive, it's costly, it's intrusive, it creates regulatory risk, it creates reputational risk. This is common ground, the Commission has said so in a number of its papers; it's not in dispute. It's desirable to avoid breaching the thresholds and therefore there's a strong incentive to refrain from doing so. If the company responds to that incentive will it be acting in a way that is consistent with the purpose of the statute? To the contrary. If the company responds to the incentive it will hold, and let's talk about the initial threshold now, it will hold its nominal price constant when it should be increasing it. So the incentive created by the initial threshold is directly counter for this group of companies to the statutory purpose.

Gault J I have difficulty with this emphasis you have on 'should be increasing prices'. If your basic starting point is there is above average productivity and so on, why should they be? They are more efficient than the average. That might be a choice they should be free to, but why should they?

Goddard It's because of the below-average profitability that my friend says that and he's right because

Gault J That's a choice.

Goddard Your Honour the problem with below average profitability is that in anything other than the short run that's not sustainable and it's not in the interests of consumers. A company needs to earn enough to meet the costs of maintenance and renewal and meet its cost of capital.

Gault J That's a great theory but this is a super-efficient company that seems to be able to do that.

Goddard It's more efficient than the average, but that doesn't mean that it can survive without earning its cost of capital, and the Commission has repeatedly emphasised that it is in the long-term interest of consumers they've said going back to 57E that companies earn their cost of company and that prices not fall below efficient levels. Also to the extent that allocated efficiencies at present in this market – inefficiencies – and that because demand doesn't vary a lot with price here. It's not a huge issue either way with prices too high or too low. Prices being too low actually send signals which are just as distorted as prices that are too high.

Gault J Well it's a good economic theory but it's leaving me struggling from a practical observation I'm afraid.

Goddard It is common ground between the parties Your Honour. The Commission agrees, Unison agrees, and all that's important for present purposes is that the incentives here do not encourage conduct consistent with the purpose statement, and coming back to my screen test, if the company were to increase prices, that wouldn't tell you that those concerns present

Anderson J Has there ever been the slightest suggestion that there's a company that's earning inefficiently low profits?

Goddard Yes. Because of the ownership distribution of these companies, many of them community owned and Trust owned, there are real concerns about whether some are earning enough to in the long run meet costs of maintaining and replacing the lines.

Gault J So the choice to reduce profits is for the benefit of the shareholders, which are the users, consumers?

Goddard Not in the long-run Your Honour because

Gault J But that's why it's coming about, or might come about?

Goddard Yes, but the Commission would say that was a misconception of what the interests of those people were. The *Caygill Report*, the Ministerial Inquiry which triggered part 4A deals with those ownership distribution issues and the huge range of rates of return that were being earned at the time, and I might a little later hand up some of the extracts from that that my friend read one paragraph from. But let me come back to these graphs now. So that's the best performance. That's just three companies. If I could ask the Court now to turn back to 1096. This is the next group that ended up with an X of 0 and there are another seven companies in this group. These are the companies that were charging prices down at this red line and they should have been up at the green line. Now again let's look back at the period of the initial price path threshold. If these companies increased their nominal price; if they lifted it above the red line towards the green line, would that tell us that the s.57E concerns were present? No it wouldn't.

Tipping J Isn't this exactly the same as the previous one although not quite so dramatic?

Goddard Yes, so it's another seven companies. So the point I'm making Your Honour is that we've got the people who were very superior performances. For them seeing a price increase doesn't tell us the concerns of

Tipping J Well you needn't go through the whole exercise again for me. I understand the point you're making. This is just another example of it at a lower level of drama.

Goddard And similarly if one considers the companies that were earning just the right price at the start of the period, if one asks does their putting their prices up indicate that the 57E concerns were present, the answer's no. The Commission expects them to increase their prices at a rate of inflation less a productivity allowance for this industry – about 1.5%. So again observing price increases for the companies that are well-performing, that are just right and for those that are performing better than that doesn't tell you anything and that's a majority of the industry. By the time you look at what the *Meyrick* report tells us you've actually got substantially more than half of the industry in those three categories. So for the majority of players in this industry, observing an increase in price isn't reflective of any concern. It is for the last group. I think from memory, it was nine or so, nine companies

Tipping J Well in relation to this group, the minority, let's assume they are a minority, how can you say that it's not capable of demonstrating a problem?

Goddard Because you don't know whether you're looking at a company in this group or not. We know it's a problem because of the other information we have.

Tipping J But it's capable of actually throwing up a problem company isn't it?

Goddard No.

Tipping J You won't find that out until you look more closely.

Goddard It's not capable of throwing up a problem company at all, it is completely unrelated. This is really important and it is not in issue, so it really needs to be pinned down Sir.

Tipping J Well I'd be grateful if you do because at the moment I'm having – I'm not against you I'm just inquiring.

Goddard No I understand. You've got 28 companies. You observe that one of them increases its price. Does that tell you you've got a problem? No it doesn't because you don't know which group it's in. Remember we're talking about the initial thresholds; this classification hasn't been carried out; you don't know who you're looking at; it doesn't tell you there's a problem. I'm going to venture just one more analogy.

Tipping J Is your point that it doesn't of itself tell you whether there's a problem, the identification of the problem depends on the next step?

Goddard It depends on more information. Without more information it tells you nothing at all.

Tipping J So this is the key point, that raising the price so as to breach the threshold does not of itself demonstrate whether there's a problem

Goddard Yes.

Tipping J The identification of the problem is dependent as you say on more information which you're going to gather at the company-specific inquiry stage - the post-breach step?

Goddard And that's what the Commission says it's doing, but what I say is that that's not what the legislation intended. The legislation intended that a threshold breach would at least involve a preliminary indication, some evidence that those concerns were present, and a price increase by itself doesn't. That one

McGrath J Well it tells you the red line's moving, and that may be a factor that is helpful for the Commission to look at.

Goddard No Sir because

McGrath J And I appreciate that the fact the red line's moving isn't significant in itself but surely isn't not a legitimate for attracting the Commission's attention?

Goddard No because you have absolutely no idea just looking at the fact that the red line's moving, whether that's a good thing or a bad thing, whether the concerns are present or not, whether in fact it's a step in the right direction or the wrong direction.

McGrath J I've said that. I understand and accept that, but then on the other hand if only one or two companies red lines are moving, it's a factor that may trump the Commission to find out whether they're moving in the public interest or whether they're moving against the public interest.

Goddard The problem with that is that you would expect healthy, well-functioning companies to have their line moving as well. You wouldn't expect it to be just one or two. You'd expect every company that was performing well to have its red line moving.

McGrath J Absolutely

Goddard And conversely the fact that the red line isn't moving does not tell you that the concerns aren't present, and that's a major problem in terms of the statutory scheme, because those are the companies you cannot investigate. So if you have a company earning substantial excess profits, and if you don't, what's the point of having this regime at all, why have we got a new path 4A? If there is such a company then it can simply hold it's nominal prices constant and continue to earn excess profits. They will under the initial price path threshold diminish in real terms a little each year, but it can sit on those immune from inquiry by the Commission, immune from price control, whereas under part 4 it would have been exposed to price control. So it's better off. All it needs to do is hold nominal prices constant and then under the revised threshold, only increase them slowly. Even the worst performers were allowed to do that under the revised thresholds. And it's immune from investigation, immune from price control, so that's the flip-side of that concern is that companies whose red line doesn't move, or which moves only by the permitted amount under the revised thresholds, escapes scrutiny when they should be scrutinised, because the 57E concerns are present. You're not testing for them.

McGrath J I suppose if the red line doesn't move that may simply indicate that the regime irrationally is preventing movement that could be in the public interests upwards.

Goddard Yes, exactly Sir.

McGrath J Yes.

Goddard And undoubtedly that has happened for some companies because of the incentives created by the thresholds.

Tipping J The problem is this isn't it, that movement may be in the public interest or it may not? Non-movement may be in the public interest or it may not, but the movement per se is not diagnostic of anything?

Goddard That's right, that's exactly right Sir.

Tipping J That's the problem which you're inviting us to identify here - I'm not stating it as my view?

Goddard Yes, that's the problem in a nutshell. So I'm going to do my one analogy and it's one that was referred to in the High Court judgment. It didn't meet huge approval from Justice Wild, but it's the suggestion of inquiring into concerns about an overweight group of children in a school. We'll hear a lot about this. You're asked to identify the children who are overweight with a view to providing you know a diet and exercise programme. If you ask which children have put on weight in the last six months, that's a question which is completely irrelevant to whether or not the children are overweight, and in fact there are all sorts of reasons why you put on weight. It could be because you've been very underweight and you're getting back to normal; it could be because you're a child, growing, and it's normal for children to put on weight, compare it's normal for prices to increase to reflect inflation. That's normal - that's what happens in a healthy, well-performing competitive market and it's a significant innovation that we're not talking about here. And

Tipping J So putting on weight within the last six months is not diagnostic of whether you're overweight today?

Goddard Yes, it doesn't tell you anything at all. If you look at a group of children and you ask who's put on weight in the last six months, that would be a completely pointless inquiry if what you wanted to do was to select those who were overweight for assistance with that problem.

Tipping J It might give you a presumption.

Goddard No Sir, it wouldn't catch people who

Tipping J It may not be the most brilliant method in the world, but it may give you at least a start.

Goddard It can't even give you that. In circumstances where it is something that you observe also in the perfectly healthy, normal person, and where people who are unhealthy but who may have been trying to do something about it, may not display that. Someone who is hugely overweight but is on a diet which is not completely effective but you know it's at least holding weight constant, would not trigger that, and that's the issue.

Anderson J What's the relevant analogy between growing children and line companies?

Goddard That prices increases over time in accordance with inflation so you expect price to increase. The Commission says in its additional work it did in the *Meyrick*, about 1% less than the rate of inflation. So with inflation at 2.5 to 3% you expect prices to go up at somewhere between 1.5 and 2% per annum. You expect the number to be going up - that's healthy, that's not a problem.

Anderson J This wouldn't apply though to the revised thresholds would it because the analogy breaks down at that point? Because you make allowance for the analogous growth by having a reference to CPI.

Goddard But you're still just looking at changes from the existing base without asking whether the existing base is a cause of concern or not.

Anderson J Whether they're overweight to start with?

Goddard Yes, and coming back to what Dr Houston said

Anderson J Well let's assume a class of adults, rather than growing children, and you say which mature adult has put on weight in the past six months, then you might get indications of bad diet and limited exercise.

Goddard It would still be equivocal, my learned friend whispers pregnancy to me very firmly, which is not the illustration which is up to me which was exercise which you know builds muscle and increases weight, but

Anderson J Well let's assume, mature adults

Tipping J Which of your learned friends was brave enough to

Chen The only one who's bred.

Anderson J Mature adult males.

Goddard Well at that stage you might be in the territory of thinking that that at least was a useful starting point, but you would have to have formed the view that you were looking at a group of mature adult males in respect of which putting on weight was not a feature of normal, healthy day-to-day life, and that is a long way from what we have now, because the Commission, on it's own view, considers that prices increasing is a feature of normal, healthy behaviour by a lines companies.

Anderson J Above CPI?

Goddard No. For a healthy well-performing company it should be increasing at a little under CPI.

Tipping J What if the, I'm sorry, just in staying with this metaphor, and I know metaphors are not to everyone's taste, what if this group of children of yours Mr Goddard are allowed to put on some weight according to normal sort of growth patterns, but the threshold is if you put on more weight than you could reasonably be expected to put on by way of ordinary growth patterns, then your analogy starts to get a bit tricky doesn't it?

Goddard And that's why I think my case is clearest in relation to the initial thresholds and becomes more complicated in relation to the revised ones.

Tipping J Well both that and this idea that it's not capable of being diagnostic for anyone

Goddard But the whole point

Tipping J Is the point at which I'm having difficulty.

Goddard A diagnostic tool that only works for the people you know are sick is not a diagnostic tool?

Tipping J But you don't know they're sick before you

Goddard No, that's right, and you don't learn anything about that by applying this test, have prices, nominal prices gone up? Let's focus on the initial threshold. You look at the companies - you say have nominal prices gone up? That tells you exactly nothing about whether the company is a problem company or an ordinary company, or a well-performing company.

Anderson J Coming back to the 9 out of 28, which is 30%, would an increase in price suggest there's a 30% possibility that the 57E purposes are not being met?

Goddard No more than the fact that if you closed your eyes and put a pin in the list you have a 30% chance of hitting one. It's exactly as helpful as that.

Anderson J 30% is better than 0%.

Goddard But the threshold's not doing anything at point Sir, and can I come back to the incentive point, because this really is a very important one, and again let's go back to page 1097. What is the incentive created by the initial price path threshold in that first period? It's not to increase nominal prices. That means the red line is getting further away from the green line. It's actually making things worse. What about during the revised threshold, what is the red line doing? There's a strong incentive not to increase price faster than that, but again it would be efficient to do so. It would be consistent with 57E to move up to that green line. So the incentive created there is also for this group of companies and the next one up inconsistent with 57E.

Tipping J Well it's a perverse incentive.

Goddard Yes, it goes exactly the wrong way.

Tipping J For some, for some it is a perverse incentive.

Goddard Yes for about half.

Anderson J Is it efficient to increase prices significantly rather than gradually, quickly and significantly, rather than gradually?

Goddard That depends on the circumstances of the company. It's not something you can answer in the abstract.

Anderson J Because this company here could increase its price under the revised thresholds, for example, gradually until it achieve an efficient price.

Goddard But if it didn't change the efficiency of it's operations; if it continued to run them efficiency so that all it was doing by increasing its prices was taking normal profits rather than less than normal profits, yes that would be unequivocally efficient, even without changing anything else in it's behaviour.

Anderson J But it doesn't apply quite as obviously to the initial thresholds because you can't have any increase.

Gault J If it increased its prices to above the green line, would that be an indicator?

Goddard Yes, and that's why if there had been a price path that looked at the starting point and looked at how far below, and in the case of these groups of companies they were from efficient prices, and it said if you change your prices by more than X that would be an indicator.

Gault J Again then it's a question of subsequent investigation as to whether it was more than X.

Goddard What Your Honour is suggesting is effectively that the subsequent investigation should do all the work. That the threshold will not tell you

Gault J Well that seemed to me to be one of the issues here. Your case advocates doing all the work for all of the companies before you set the threshold which you say is a better scheme than doing it case-specific when a company is called for examination.

Goddard That's not my case, although it is how the Commission has sought to characterise it. My case is not that the work has to be done for all the companies at the threshold stage. There are a number of ways in which thresholds could be set that paid attention to company-specific factors without doing all the work up front. It's also the case that one

Blanchard J Are you going to tell us about those

Goddard In fact if the Court turns over to, I'm sorry, the other way of looking at it is that it's possible work for each company but not as precisely as would be required at the control stage, that you apply a rough cut, what the Commission did to set the revised thresholds, and you do that at the threshold stage. So turning over to tab 40 of volume 7, the Court will see a table that we prepared showing how *Meyrick and Associates* classified the various companies. Your Honours will see that in the top left-hand corner there are the companies that are most efficient and with the lowest rates of return. Three of them – Northpower, Otago Net and Waipa Networks, and then moving across the first row there's the group with the lowest rates of returns but average efficiency, and then least efficient and so on down. So this is quite a quick ready reference to how many companies you've got in each of the groups in my friend's graph for example.

Blanchard J How long did it take *Meyrick* to establish this?

Goddard It was established by December 2003 when their final report was published and they had an initial report, I think from memory, September, but I'll check that. So at the same time that the first assessment was being done under the initial thresholds, this work had been completed, and what I say is that this illustrates another way that one could have done it because,

and this is very similar to what the Ministry of Economic Development were proposing, but simpler in 1999.

Gault J This is an argument that the revised threshold meets the requirements is it?

Goddard No Sir, because I say that the way this work was used is inconsistent with what the statute required, but in terms of what work is required, enough work had been done. Let me suggest one approach that could have been adopted which would have been unimpeachable in terms of the statutory scheme. If the Commission had said once a year we're going to ask our consultants to do this, using available data, and we are going to say that the threshold is triggered if you get a score on these two factors of one, then we'll investigate you. As it turned out there weren't any companies in the outside box, but if you get a score of 1 or greater - so if you were one of the least efficient and had the highest rates of return, the empty box in the righthand bottom right, you get a score of 2, you'd be investigated. You've breached the threshold. Also if you had a say an average rate of return but you were least efficient like Eastland and MainPower and Marlborough, you breach. If you had a score of 1, you're in breach. That would do it. Or if you were

Blanchard J Now do we have any evidence from experts about this theory that you're putting up?

Goddard No, because the whole case is preceded on the basis that it wasn't necessary to say how the Commission should have done it, that this wasn't about whether it was done well or not, the question was whether they adopted the right approach. But the questions have since been asked was it possible to do it in a way that worked, and what I say is that Mr Sundakov's evidence describes one such way which is a price path with a P zero adjustment, that's one, but it's emphatically not the only one and

Blanchard J Well the Sundakov method would involve quite a lot of individual investigation wouldn't it?

Goddard No more than this Sir. You could have used this work to set a PO. It wouldn't have been as precise as the one required for control, but it would have been enough, and again I think this ultimately ended up being common ground below

Blanchard J Your asserting that, you may be right, but how do we know that you're right in that assertion about the amount of work that would have needed to be done?

Goddard That fact that *Meyrick and Associates* estimated rates of return shows in itself that there was enough information from which to derive a rough

adjustment. You could start drawing the pictures that my friend had drawn.

Blanchard J Well do we know what information they had, how it was being gathered, when it was being gathered?

Goddard It's all in the *Meyrick* report before the Court which is very long and full of tables and data from which one could do this. But again

Blanchard J It's going to be quite an exercise for us if we have to do that.

Goddard Your Honour doesn't have to do this because it's not about the Court saying here is another way that it could have been done, which is better. That's precisely what I'm not allowed to argue, and is what I'm not arguing. What I'm saying is that it was possible in a number of ways to have thresholds that would screen, even if more work was required, that does not mean that the Commission shouldn't have done what the statute involved, but in fact, and this is just an observation, I'm noting that by December 2003, enough work had been done, and it's a point of submission not evidence, to enable something like what Mr Sundakov described to be done or what I've just described to be done, and the fact that that could be done is apparent from the fact that it was done, the sifting into efficiency and productivity.

Tipping J Is the effect of Mr Sundakov's evidence in very short terms that a price path methodology is not diagnostic without a P zero adjustment?

Goddard Yes, or some other

Tipping J Or some equivalent?

Goddard Yes, exactly. Something that looks at what assets are and what rate of return you're earning, and what your efficiency is.

Tipping J It's not diagnostic of what it ought to be diagnostic of.

Goddard Yes, it's not diagnostic of the s.57E concerns. It's not diagnostic of excess profits; it's not diagnostic of inefficiency; it's not diagnostic of a failure to share efficiency gains with consumers.

Tipping J Yes, I think I understand what I'm saying Mr Goddard.

Goddard Yes, I'm just checking that I do Sir, not that you do. I would never be so presumptuous. I think we're at 1-0. What I'm saying

Anderson J Now what you're saying is you don't have to show how it can be done, you have to show that this section doesn't work, or is not lawful.

Goddard I have to show that that's what Parliament wanted to be done and that it wasn't done, that's right. And I'm by way of comfort, and it's no more than that, I'm saying yes it can be done and it could be done by December 2003 – that's actually not.

Tipping J Well if it's not diagnostic at all, subject to further argument and any attempt by people to say whether that means per se that it's unlawful, then it doesn't matter much what could have been done, all that matters is that this one misfired.

Goddard Exactly Sir, and that's what I say. Now I don't think I need to go to Mr Sundakov's evidence because Your Honour summarised it much more elegantly than Mr Sundakov did.

Tipping J That's a frightening thought Mr Goddard.

Goddard Yes, next time I'll call Your Honour as my expert instead because it will shorten the evidence considerably. But if I could just give the Court the reference. It's under tab 12 in volume 2 of the case and the key paragraphs are paras.14 to 17. So it took him four paragraphs, where it took Your Honour one sentence, but it's not too long as evidence goes on that issue. And that point, the point that an increase in price does not tell you anything about the presence of those concerns, is not the subject of any evidence to the contrary from the Commission, or anything in the record before the Court, and that's not surprising because as a matter of logic it couldn't be. It's helpful also, I took the Court to para.76, but there's no substitute for actually hearing from the decision-maker about what they thought they were doing before we turn to the initial decisions. If I could to look at volume 2 of the case and turn to Ms Rebstock's affidavit, Chair of the Commission, under tab 15, and the Chair after noting in para.4 uniqueness of the targeted control regime, and in para.5, the advantage of it in terms of avoiding implementation and compliance costs. It moves on to para.7, and this is the paragraph to which I want to draw the Court's particular attention. 'Part 4A requires businesses to face incentives to make efficiency improvements and achieve profits commensurate with those in a market with workable or effective competition. The thresholds act as both an incentive mechanism and a screening device. What does she mean by that? The incentive mechanism works by encouraging businesses to keep their performance within the thresholds; undoubtedly true, but of course the question is "is that or is that not consistent with 57E". The screening device works by screening out those businesses whose performance remains within the thresholds from further consideration under subpart 1 of part 4A'. So the sense in which Ms Rebstock uses

screening is the same as the sense it's used in para.76, that it screens for the people who don't do what the thresholds require. No more than that.

Tipping J Well that's a screening out concept rather than a screening in concept isn't it?

Goddard You could have written that the other way around though Sir because it screens in the companies whose behaviour is not consistent with the thresholds.

Tipping J Yes, I suppose so. One's necessarily the obverse of the other.

Goddard Absolutely.

Tipping J Yes.

Goddard Two sides of the same coin. What I think I'd like to do now is go to the initial threshold decision, because when one is seeking judicial review of a decision, it's a pretty good place to focus, but strikingly the Commission's don't. They don't even refer to it. It's in volume 3 of the case on appeal, pale mauve. The Gazette notice is under tab 19. We don't need to go to that. Just note that it's dated 6 June 2003 and then over under tab 20 we have the Commission's Targeted Control Regime Threshold Decisions of 6 June 2003. It's a substantial decision paper, 33 pages long. One would expect to find in it some record of what it was that the Commission set out to do and of its thought process. The reasons for why it got there certainly in my submission in the context of Judical Review proceedings it's the right starting point for asking what did the Commission ask itself. There's an interesting question about how far that's properly supplemented by evidence from the decision-maker, but here we have evidence from Ms Rebstock and she explains what she means by screening and doesn't otherwise elaborate on that point, so it's not really an issue. Let's look at the decision paper. Turning over to the first substantive page, page 334 of the case, Executive Summary, it's the second paragraph 'after consulting with interested parties the Commission set two thresholds and then these thresholds will provide incentives for lines businesses to maintain the quality of their services while reducing their prices in real terms'. And that's absolutely accurate, that's what it does, and that's all it does, come on to that. 'The purpose of the price path threshold is to provide incentives for lines businesses to reduce their prices in real terms'. That's undoubtedly true, and it goes on to say 'and therefore to improve efficiency, to be limited in their ability to extract excessive profits and share benefits of efficiency gains with consumers'. And as I noted a moment ago from going through the graphs as a matter of logic that's only true for about a third of the companies. That's also confirmed by the evidence. 'The purpose of the quality threshold is to provide incentives

for lines businesses to not allow their reliability to fall, as a means of reducing costs in response to the price path threshold'. Just note the linkage there between the two, that's the only reason I go to that paragraph. And to incentivise them to provide services at a quality demanded by consumers. Thresholds – coming down to the heading towards the bottom of the page. 'The thresholds are a screening mechanism to identify lines businesses whose performance may warrant further investigation and if required control by the Commission'. So that's what thresholds should do.

Tipping J You don't quarrel with that? Your argument is that these don't achieve that purpose.

Goddard That the Commission didn't ask whether this one would and it can't do it, yes.

Tipping J Yes. You don't quarrel with that in the abstract?

Goddard I don't as long as it's understood that by performance may warrant further investigation is that there's some reason for thinking that the performance is outside the 57E, yes. The Court flagged some concern about this word 'screening' and its slipperiness yesterday and I think that that's right. One needs to be very careful about people saying it's a screening mechanism. It's isn't because it means so many different things – screening mechanism to different people, and that's why to ask screen for what is always critical. So it goes on to talk about assessment and the threshold assessments are set out in a table that summarises very helpfully what's involved on each of the assessment dates. Immediately under that table 'the price path assessment criteria are consistent with a CPI-X price path, in which prices at the end of each assessment period are not greater in nominal terms than prices at the start of that period'. Now I suggested yesterday that I didn't think it was particularly helpful to describe it as a CPI-X price path when X wasn't a constant but was CPI, but that's not a big deal. The rest of the sentence

Tipping J Well that presupposes the X as CPI.

Goddard It's common ground that the test in the Gazette notice doesn't refer to a CPI and doesn't refer to X, it just says are your nominal prices the same?

Tipping J But that statement there presupposes for its validity that X is CPI.

Goddard That's not what the Commission did other than implicitly by setting a zero adjustment factor.

Anderson J Well the formula can be true and the values can change, and they did change really with the revised threshold.

Goddard At the revised threshold there were X values, but here there weren't. There wasn't a CPI figure, there wasn't an X. If one flips back to the Gazette notice, and I won't go through it in detail now, but I

Tipping J I don't really want to divert you Mr Goddard here. I don't think there's a problem here.

Goddard Okay. I just did want to emphasise that this is not a situation where an X has been set. It was just a flat price.

Tipping J No, no, no.

Goddard That was what was required was that nominal prices not change from the level at 8 August 2001 or any lower level at any time between then and the assessment date. You were stuck with your lowest prices.

Tipping J No, no, no.

Goddard In discussion of the quality threshold assessment, the purpose of the various criteria, we needn't go through that in detail. Over on 336, thresholds to apply from 2004. 'The Commission expects it will set different price path assessment criteria to apply from that date'. It talks about what was proposed to be done and what in fact was ultimately done.

Gault J That raises a point I'd be interested to have some help on Mr Goddard. This follows the passage in the affidavit just referred to where the Chair of the Commission referred to 'building a threshold regime' and this talks about the different assessment to be made, and further over on 358, it talks about the proposed further work to set different X values. This seems to have been regarded by the Commission in the material they were putting out as a process rather than a one-off discrete determination that is the end of it. They rather said they were working towards, or building a regime by process that seems to involve both the initial and the revised. Should we be looking at their work in a slightly wider screen than focusing on just one individually and the other one individually?

Goddard It's certainly appropriate to take account of the fact that there was a power to make thresholds from time-to-time, and that one would expect the regime to improve over time. Those were all expectations that Parliament could reasonably have had, but, and it's a critical but, each threshold decision must still be in itself consistent with the statutory purpose. It doesn't need to deliver it in a one-off big bang, but it must be consistent with it, and in particular not inconsistent with it.

Gault J No but might there be something to be said for 'working towards meeting the statutory purpose'?

Goddard No, in my submission the Commission must always act consistently with it. Sometimes that may mean a recognition that improvement will be possible over time but one still has to be on the continuum, to use my friend's phrase,

Gault J Well I understand that if they're working towards it that's not inconsistent with it is it?

Goddard That comes to perhaps my even more important qualification which is that you must be working towards the right thing.

Gault J Well I accept that obviously.

Goddard And in my submission that meant that it was possible for the Commission to, for example, come up with a rough diagnostic tool first time around and then refine the diagnostic tool over time, and what it couldn't do was refrain from seeking to develop a diagnostic tool at all, and that's what it did.

Gault J That's what I'm asking you. Were they refraining or were they working on the development of a diagnostic tool?

Goddard Well given that thresholds had to be a diagnostic tool, if they didn't feel they were in a position to make a threshold that was a diagnostic tool, then yes, they should have done nothing.

Gault J Well I understand that.

Goddard Because of the risk of perverse incentives quite apart from anything else, it's not the case that something is better than nothing here. If you do the wrong thing – and this is an issue with all regulations – if you do the wrong thing you're actually likely to make things worse, not better, so it's critically important to be headed in the right direction. Dr Friend once said to me that the first rule of all medics is above all do no harm, and if you're not confident that you can do something that will make it better, you should do nothing, and that's actually true of regulators as well. You need to have a level of confidence their intervention is more likely to serve the statutory purpose than not before just doing something, and that's the test that wasn't applied here. Coming back to the initial decision, I was on page 336 of the case, that concludes the executive summary, and we begin the body of it, and what we're reading for is two things on my approach. We are reading for the Commission saying who will breach this and what

will it tell us and we're reading for the Commission saying what incentive will this create and they are consistent with s.57E? Those are the two central questions for setting a threshold under this regime. There's an outline of the process that's been followed in paras.1 to 3, a table setting out the structure, and immediately leaping down to the next column, you see how the price path threshold works in concept, and that's going to be the important bit. Process to date, targeted control regime. Para.9, thresholds for declaration of control – all very familiar stuff. Worth pausing at 339, review of asset valuation methodologies. The Commission notes that it released an issues paper on that and sought responses. And then para.15 'the threshold assessment criteria do not rely upon regulatory asset valuation and in that sense the decisions set out in this paper do not relate to asset valuation. So there's no linkage to asset valuation at all, and yet as Dr Houston said in his evidence to the Commission, and again this is undisputed, you can't assess whether or not a firm's earning excess profits unless you do asset valuation. There's no way of doing diagnosis for that without looking at valuation. You can do rough diagnosis by using a rough valuation and then improve it at the second stage by doing a more precise one, but if you aren't looking at asset valuation, you aren't looking at whether or not they're excess profits, because there's no other way known to human-kind of doing that. The thresholds. 'The thresholds are a screening mechanism to identify lines businesses whose performance may warrant further investigation if required, control by the Commission. That same sentence again, which Justice Tipping asked me if I agreed with and I said yes, as long as it's understood that performance warrants further investigation if there's some evidence of the 57E concerns. To thresholds set and the same summary table. Reasons for not setting a profit threshold. Over on 341, para.24 is interesting. 'The commission's preferred way to ensure lines businesses are limited in their ability to extract excessive profits, which the purpose statement requires is to consider the efficiency of prices and costs as part of the resetting of the price path threshold. In other words, we're not doing that now.

Tipping J Where were you reading from? I'm sorry

Goddard Sorry Sir, para.24.

Tipping J 24, thank you. Just read that again for my benefit please.

Goddard 'The Commission's preferred way to ensure lines businesses are limited in their ability to extract excessive profits, which the purpose statement requires, absolutely right, is to consider the efficiency of prices and costs as part of the resetting of the price path threshold'. So that's saying we haven't done efficiency. We saw earlier a paragraph that said we haven't done asset valuation, so we haven't done profitability, and now we have the Commission saying oh and we haven't done efficiency either. 25 is

also important because my friend has at some stages of this proceeding, although I'm not quite sure where he is on this now, suggested that the Commission knew that everyone was earning excess profits and was overweight. That's not in fact what the *Caygill Report* suggests, and it's not what the Commission itself was saying in para.25. The Commission considered submissions on a level of profits currently being earned. Some parties have submitted current price levels reflect excessive rates of profit, particularly when re-valuations are treated as income. The Commission expects to make decisions on the measurement of profit as it develops its methodologies in relation to the investigation and control phases. The issue may also arise in the context of resetting the price path threshold, so the Commission has not looked at this now, and doesn't have a view on whether there are people earning excessive profits and if so how many there are. This is not predicated on a view.

Tipping J They presumably haven't done this because they haven't done the asset revaluation exercise.

Goddard Yes, which they were told to do as soon as practicable, like the setting of the thresholds.

Tipping J Yes.

Goddard The threshold assessment process then just goes through the machinery provisions for the next couple of pages. Turning over to page 344, price path threshold, broadly comparable to the various forms of CPI-X price control under para.40. However the thresholds are not instruments of control and the threshold differs in many important respects from the price control mechanisms used elsewhere. The same sentence to give summary consistent with CPI-X, nominal prices stay the same, and in para.44 'the purpose of the price path threshold is to provide incentives for lines businesses to reduce their prices in real terms, and that's true, and therefore to improve efficiency limited in their ability to extract excessive profits and to share the benefits of efficiency gains with consumers, that is indeed the purpose of thresholds, but there's no discussion at all of whether this one will do it and that's it. There's some stuff about Transpower. There's a discussion of the quality threshold, beginning at page 353, and perhaps just worth noticing again on page 354, para.80 that statement that 'the purpose of the reliability criterion is to provide incentives for lines businesse4s to not allow their reliability to fall as a means of reducing costs in response to the price path threshold. The two travel together. The quality is there to manage what might otherwise be perverse incentives created by price path.

Anderson J Could you have a company charging inefficiently low prices which breaches the threshold and is then put under price control to increase its

prices against the wishes of its consumer owners, so that you have to resort to a control mechanism?

Goddard It's theoretically possible.

Anderson J Well then doesn't that break down your argument to some extent?

Goddard No, because you need to be testing for the failure to increase prices. If such a company sat on its low prices inefficiently, it would never breach a threshold, so it wouldn't be caught.

Anderson J That's true, but if it did breach the threshold then it could be subject to control which would increase its efficiency.

Goddard But the irony of that is that it would only breach the threshold if it were already doing something about it. It would be exactly back to front. It would be like only picking up someone who was sick once they were getting well of their own accord. I think I had promised that there weren't going to be anymore metaphors.

Anderson J Well let's say if they try to do something about it they could be forced to go at a faster rate for example.

Goddard But if they were doing nothing, they wouldn't be caught. So the threshold doesn't test for that concern because it only takes an interest in whether you failed to increase.

Anderson J I'm sorry, it's a bit of an insight, it was the

Goddard No it's an important question, it's actually really important because it picks up this whole concern about some types of failure to act consistently with the purpose statement simply not being tested for at all, and therefore there being no possibility of control. There a discussion of the reliability criteria for distribution businesses and for Transpower; at 356 consumer engagement criterion, demonstrating compliance with the quality threshold and then beginning at the foot of page 357, next steps, the Commission explains what it's going to do in the future. At page 359 and following there is a discussion, well just on page 359, in fact there's a note about information disclosure, and then are some annexes; a glossary with some helpful definitions; a comment at annex 2 about the reset process, and timeline for that, and annex 2, work on the investigation and control phases. So we've made it through to the end of that and two things are completely absent. The first is any discussion at all about screening in any sense. Any discussion at all about whether the fact of a breach of the threshold will provide information about the presence of 57E concerns. Even on my friend's formulation in 76, with the word 'efficient' in there,

there's no discussion of that either. There's no discussion of whether this will single out businesses that fail to behave in an efficient way. There's simply nothing about it. And if the Commission had asked will this diagnose, or the 57E concerns, there was only one answer that could have been given and that's no. And what about incentives - the issue that the Commission puts at the forefront of its description of what thresholds are meant to achieve, the point emphasised by the Chair, are words certainly that occurs pervasively through the decision. What discussion is there of the incentives created by the initial threshold which says 'hold nominal prices constant'. Again exactly none. There is not a sentence analysing what incentives the threshold creates, and yet in my submission that was the equally important critical issue that the Commission had to consider. It had to ask itself two things. Will these diagnose for the 57E concerns? Will these proposed thresholds create incentives to act with consistently with 57E? They didn't ask either of them. The decision is quite simply silent on them. Ms Rebstock hasn't suggested in her affidavit that they considered those questions. It's not one of those situations where a decision-maker comes along later and says oh we didn't write it down the decision made, but this is what we looked at and we considered that it would do these things and that's not surprising because that just couldn't be said, and that's one of the key points on which Mr Sundakov gave evidence, but it's actually a matter of pretty elementary logic in my submission anyway. What the Commission was doing was trying to hold things constant and prevent gaming, to use my friend's term, to discourage price increases while it finished its work. But it wasn't given a power to do that. It didn't have a statutory power to, as it were, grant interim injunction stopping everything until it could make a substantive decision, it had the power to make substantive threshold decisions, and everyone of those had to be consistent with the statutory scheme.

Tipping J Would it be albeit a bit colourful but accurate in your submission to call this a de facto price freeze?

Goddard Yes that's what it was. It's actually no different from what Mr Hodgson said he did when he got on the phone. Back to that Hansard passage that Your Honour was a little unhappy

Tipping J Not very keen on.

Goddard Not very keen on, that's putting it mildly I think. What he said was we wanted more time while we looked at doing better legislation, so he got on the phone to the lines companies and asked them if they would do a voluntary nominal price fix.

Tipping J Yes with respect

Goddard Same thing.

Tipping J There's no need to go into all that. You'll just irritate me again Mr Goddard.

Goddard I'm sorry Sir.

Tipping J I'm just looking for confirmation or otherwise as to whether this expression that I've just assayed will capture the point you're trying to make.

Goddard Yes, that's exactly what it was. It was not only de facto, it was de facto de jure, everything, a price freeze.

Tipping J Well it wasn't per se, you could breach it. That's why I said de facto.

Goddard Right, but then you exposed yourself to all the risk and costs

Tipping J Oh yes, you exposed yourself but it wasn't a, well never mind.

Goddard Yes, it was a situation where a price freeze was put in place with significant and unattractive consequences if you breached it, but not actually control, so yes you're right, there was no legal obligation to price in this way but there was a strong incentive to do so. And

Anderson J Particularly if you couldn't justify it.

Goddard Whether or not you cold justify it you were exposed to the costs and uncertainties of this, and this was at a time Your Honour would have seen that the future work included the publication by the Commission of its assessment and inquiry guidelines. No one knew what the Commission was going to do following a breach. How much information would need to be provided? What the costs and processes would be? That was yet to come. So very critically you were exposed to a lot of uncertainty about what it meant for you, and to the risk of control. And just pausing here, it's worth noting that the position of the Commission is that if you breach any threshold for any reason, it can conduct a full inquiry into all aspects of the business, including things the thresholds don't test for, like whether you need recovering a lot more from one consumer group than another, and that's then the essence of the investigation of Vector for example. It breached by a minor amount because of budgeting issues in relation to Transpower charges, about $76,000. The investigation that followed looked at the balancing of recovery between Wellington and Auckland consumers and there was an intention to declare control based on that, nothing to do with the breach as such. So the possibility that you were opening up a much broader inquiry into sub-issues not tested for in the

thresholds was a concern which has proved to be totally well-founded. So that's the initial threshold decision. I'm about to turn to the revised one. It's 28 past 11, I wonder Sir if

Blanchard J Yes, that would be a convenient time for us to take a break, thank you.

11.29am Court Adjourned
11.45am Court Resumed

Blanchard J Thank you. Mr Goddard we're becoming a bit worried about the time.

Goddard Yes I think that's well-founded Sir.

Blanchard J You have been wandering around an awful lot. I think the main point you seem to have been making, although you probably wouldn't put it this way is that the initial threshold was unfit for purpose and that the only reason for doing it effectively was to stop gaming, and they couldn't do that because there was no power to put in place a threshold for that purpose. Now that's taken 2 and a half hours. We've really got to move faster now. We can't sit tomorrow.

Goddard The indication that the Court can't sit tomorrow is helpful.

Blanchard J Well we've never been asked for a third day. We simply can't do it and we won't be able to find another day until at least August.

Goddard I do, I absolutely understand that Sir. My friend took a full morning and half an afternoon to go through the material I'm going through now and I'm trying

Blanchard J Well I'm not stopping you now, I'm just warning you that we are likely to run out of time.

Goddard I think that's a real issue. I think that we're going to end up requiring most of the rest of today to, well it might help clarify what order the Court wants to take the issues, and what I'd assumed but if I'm wrong please do tell me, is that I should do the whole of my argument now.

Blanchard J No.

Goddard No, you just want

Blanchard J No, we want to consider unlawfulness before we consider relief.

Goddard So in that case

Blanchard J But certainly the whole of your argument on unlawfulness, and you were about to move to the second threshold.

Goddard And I'm quite well advanced on my argument on unlawfulness. I envisage that

Blanchard J And then we'd hear Mr Dobson in reply, and at that point we will consider where we've got to both in terms of any view we may immediately have reached on that issue, and assuming that we wanted to hear on relief how we would go about doing that given the time.

Goddard That's very helpful Sir. In terms of lawfulness, we've gone through the initial threshold decision and just before leaving it there is perhaps one note I should make now that I've taken the Court through it with some care, and that is that the Court will have noticed that there was no discussion anywhere in it of what an X should be if the Commission was setting a CPI-X price path threshold. The reality is that from the idea of a de facto price freeze, to use Justice Tipping's phrase, the idea that this could be described as CPI-X has been reverse engineered. This wasn't a case of the Commission saying let's do CPI-X. Let us turn our mind to X should be. Oh, there is a good reason for X to = CPI. There's no discussion of what X should be anywhere in that, and in particular there are no echoes at all of my friend's interesting argument that the Commission considered that productivity gains at roughly the rate of inflation could be achieved over the two and a half years, and therefore it was appropriate to set an X=to CPI and have a nominal price freeze. That simply doesn't turn up in the decision. So that argument in my submission doesn't in fact describe what the Commission did; isn't reflected in the decision; isn't reflected in the evidence of Ms Rebstock for the decision-maker; and is actually inconsistent with the results of the *Meyrick* report published a few months later, which suggested that the productivity increases one could expect over and above general economy productivity increases were in the region of 1%, not the 2.5 to 3% at which inflation was running. Turning then to the revised thresholds. The Gazette notice is under tab 21 and I will just ask the Court to note a couple of elements of it. The first

Blanchard J Well it might be helpful if you told us boldly what your argument is on the second threshold and then go to the detail because otherwise we wait an awful long time for the punch line. We waited a terribly long time for the punch line on the argument we've heard up until now. It's the message I was trying to give you at the behest of my brothers.

Goddard The punch line is that the revised thresholds are unlawful for three reasons. First misdirection. The Commission didn't ask itself whether these thresholds

Blanchard J Is that the same argument that we heard before?

Goddard Yes, exactly the same.

Blanchard J Okay, we can skip that.

Goddard Same misdirection. Second, not capable of performing the statutory function, not fit for purpose to use Your Honour's phrase, which is a bit brutal but it summarises it concisely, and third, and this is an additional reason, because it is founded on, built on the initial thresholds. If they are unlawful then because these thresholds are based on the initials thresholds and to substantively incorporate them, they must also fall.

Blanchard J I think I'd take a fair bit of persuading on that argument, but you'll get to that in due course.

Goddard I will, because in my submission it is indeed the position on this and it reflects the Court of Appeal decision in the *New Zealand Fishing Industry Association* case which I think Your Honour might have been on the Court

Blanchard J Yes, and I think Justice Tipping was in it as well.

Goddard Ah, Justice Tipping

Tipping J Well there are so many fishing cases, I can't remember

Blanchard J That's notable for being a case where we very nearly said that the Ministry have acted irrationally. It's a fairly extreme case.

Goddard The relevance of that case for present purposes that having found that in relation to the initial decision on total allowable commercial catch of snapper, the reduction from 4,000 and something tonnes to 3,000. The following year the Minister decided to hold it at 3,000 and the Court said well that was based on

Blanchard J I don't see it as being at all analogous but you can pursue that argument if you like.

Goddard It is analogous and yes Your Honour despite that indication I will. The technical point which I don't need to dwell on at length is, because it reflects underlying substance which I will come back to, is that the start

price for the purpose for the purpose of the revised thresholds was the highest price permitted under the initial thresholds as at 31 March 2004, so

Tipping J Is it possible for you to present this on the basis that look this is what they added if you like in the second go, but that doesn't actually save it? Is that a possible way of presenting the argument because for my money that would be helpful in the sense that if you've persuaded us that the first one is no good then you say well these are the points of distinction and they don't save the day either, or is that not how you'd planned to address us Mr Goddard?

Goddard Unfortunately the issue is what hasn't been added and the only way to see that is by looking at it.

Tipping J Alright, no, no, I accept that it may not be possible to do it that way.

Goddard I can pick up from Your Honour's question what more was needed for this to be a useful diagnostic tool which was

Tipping J Well at least, PO

Goddard Or some other reference to profitability. Some other mechanism for taking account of profitability however roughly and some other mechanism for taking account of efficiency however roughly. The thing is that none of those featured at all in the initial thresholds.

Tipping J Could you say what was needed conceptually

Goddard Was something which assessed the level of price change, if you were going to look at price paths. If you go to a price path then what was needed was something which measured the price change against by reference to pre-existing profitability, pre-existing efficiency, because without those things you have no idea what it's telling you.

Tipping J A reference point in other words?

Goddard Yes, and despite having done the work that would have made that possible in the revised thresholds, again punch-line, my submission is that the way it was used, which was simply to look at the level of permitted price change, didn't fix that because you still weren't saying 'but where are we starting from'? And I'm going to deal with that by reference just to two things - the decision itself, and I'm going to go back to the graph and show what that meant there.

Tipping J So it's vice was that it did not fill up the efficiencies in the first one?

Goddard Yes, and the

Tipping J It's not that something else was added, it was the failure to cure the problems in the first one?

Goddard Yes.

Tipping J Is the essential vice.

Goddard Yes, and the reason that happened again is not because the Commission failed to achieve what it set out to do, it's because it set out to do the wrong thing, and that's much clearer in this decision, and that's another one of the reasons why it is worth going through, that the Commission was very explicit about the key principles it applied in designing the thresholds, and what Your Honour will see is that there's no mention of screening of any kind in that. The decision is under tab 22, it's 64 pages long compared with the previous that was 34, so inflation at work. Executive summary. It's a useful summary of what the paper does. It sets out the history. Halfway down the page on 390 a heading the thresholds. Try to set thresholds after consulting with interested parties. It decided to set two thresholds, a price path of the form CPI-X and a quality threshold. The thresholds are of the same form as the thresholds set on 6 June 2003, the initial ones, however new criteria and X factors apply. And there's a description of how it works which my friend has gone through with the Court. A lines business will breach if it goes through the CPI-X set for that company. We move on to the heading the purpose of the thresholds. The purpose of the price path threshold is to provide incentives for lines businesses to improve efficiency and share the benefits of efficiency gains and be limited in their ability to extract excessive profits. I agree that's one of the purposes. The screening one is completely missing. The purpose of the quality threshold is to provide incentives for lines businesses to now allow their reliability to fall as a means of reducing costs in response to the price path threshold – just note that linkage again – and supply at a quality demanded by consumers. Setting both acknowledges there is a trade-off between price and quality of lines services - linkage again. And combination – in otherwise they're a pair. They travel together. The two thresholds are consistent the Commission says with targeted control regime for the long-term benefit of consumers consistent with the specific outcomes sought in the purpose statement. The discussion of how the X factors were set – the Court's familiar with that.

Gault J Mr Goddard you said that the Commerce Commission set out to do the wrong thing. The statement of purpose there seems to be unobjectionable.

Goddard It's only half the picture Sir, it didn't set out to screen. It set out just to worry about incentives and it didn't set out to screen. So an integral element of the purpose, the core function of thresholds was not sought to be achieved.

Tipping J In other words is this in conventional administrative or a failure to take account of a relevant to take account of a relevant consideration?

Goddard Yes.

Tipping J I'm not trying to be pedantic Mr Goddard but that's where it would fit in to a conventional, it may bear elsewhere too.

Goddard It could equally well be characterised as asking the wrong question as a matter of law. The two travel together. But yes I say, and that's how it was pleaded, that a mandatory relevant consideration screening for the 57E concerns was not taken into account. There's a note about consultation expert advice on 392 and then quite a detailed summary of the B factory, 1%. The relative productivity factors C1. The relative profitability factors, C2; overall X factors by combining them and then there's the table over on page 7. Then to the body of the paper; then purpose and scope of the paper outlined, structure, and then

Blanchard J Why are you taking us through this so laboriously?

Goddard Because it's what's not in here that's critical.

Blanchard J Well wouldn't it be desirable simply to say there's nothing in there about such and such?

Goddard I thought it might be helpful to note what was and was not in there because these are the two decisions that are at the heart of this challenge, but if the Court has read these and is comfortable with broad assertions of a general kind about them, I'm very happy to take it a bit faster.

Blanchard J Well if Mr Dobson comes back and says that you're quite wrong and that at page so and so there is something about it then we'll look at it, but for the rest of us it's just wasting time I think.

Goddard In that case I'll move more quickly through it. There's the same in para.9 on page 399 - there's a reference to screening and I should therefore draw the Court's attention to that. There's that same phrase that occurred in the initial report 'in effect a screening mechanism to identify lines business whose performance may warrant further examination through an inquiry and if required, control. But the Commission's made it very clear in its submissions in its evidence that's not the same as diagnosis of the

concerns. It's not what it meant by that. I can then move the Court through to page 403, the thresholds. There's a description of them, and then on page 404, the purpose, and again just ask the Court to note that the purpose of the price path threshold is described solely in terms of incentives and likewise the quality threshold - no reference to screening; no reference to diagnosis. On page 405 there's an italicised heading, starting price, and that's where the Commission proposes the relevant prices will be. The starting price will be the same as the average price at the second assessment date under the initial thresholds. That's where that's incorporated. Threshold assessment processes is explained at page 18 and following, but the critical part of this decision begins on page 416 of the case, under the heading conceptual approach. This is where the Commission explains what it thought it was doing**.** It talks in para.98 again about the two quality thresholds operating in combination – that's that point that they travel together, and there is trade-off in 99. Role of the thresholds. There's some concerns that you can't meet all of the objectives. Purpose statement won't be fully achieved in the case of every lines business by the price path and quality thresholds alone, and it's common ground that's not required. The last sentence in 101 is interesting. Under the targeted control regime, the price path threshold is not an instrument of control but a screening mechanism to identify businesses whose performance might warrant control. Again I take no issue with that statement, it's just that the Commission never asked itself whether its threshold would do that.

Tipping J But it's not fair to say there was no reference to screening in this

Goddard The wording screening occurs repeatedly, but that's where I say the word is a slippery word and it's very important to understand what the Commission means by screening. The two most helpful statements of that are in Ms Rebstock's affidavit and in para.66 of my friend's submission. Be screening all that was meant was selecting the companies that didn't respond to the incentives created by the thresholds, not diagnosis of the concerns. So again if one avoids the screening language, if what the Commission was required to do was to set thresholds which shed some light on whether the 57E concerns were present, which is certainly what thresholds are meant to do under part 4, if they're the same thing under 4A, and in my submission they are, the Commission didn't try to do that. Over on page 417, heading key principles, there's a very helpful table which summarises the key principles for setting the thresholds, and if one looks at the table there are two things. The first category is regulatory framework incentive effects. Provides incentives for improved efficiency from time-to-time and then implementation basically, methodologically robust, cost effective – this is how easy it is to do. Then there's discussion of incentive effects for the CPI-X price path threshold which I'll come back to in a second, but let's just look at the headings now - incentive

effects of the quality threshold. And that's it, that's the end of the discussion of key principles. So when one looks at what the Commission saw as the key principles by reference to which it set these thresholds, there is no mention of screening in any sense, and that's not surprising because the sense in which the Commission referred to screening, it wasn't an objective of setting the thresholds, it was simply something that dropped out from them because inevitably when you applied them you caught the people who didn't respond to the incentives they created, and you didn't catch the people who did. Screening was never identified as an objective. Diagnosis was never identified as an objective. Nowhere in this decision does the Commission ask who will this catch? Are those people likely to raise 57E concerns? Are the people we don't catch likely to be well-behaved? There is not a single paragraph of analysis of what sort of sorting is effected by the thresholds of who will breach and who won't, and yet in my submission that was the central goal of the statutory regime, was to sort, and by that means to incentivise. There is not a reference to incentives and that argument is a more complicated one than the one in relation to screening. The objection in short is that the Commission did not anywhere say what incentives are created by these thresholds? Describe them and test whether or not they're consistent with 57E. In my submission that was necessary and I may not need to physically go back to the graphs. Just as the initial threshold discouraged for example those best performing companies from increasing their prices all the way up to the green line from the red, so too the revised created incentives for those best performing companies and for the next group – a total of ten of the 28, about 35 or 36% not to act consistently with the purpose statement. But that's not even asked in here. So again in a nutshell the Commission didn't ask what incentives its proposed thresholds would actually create and it didn't even discuss the fact that for at least a third of the companies under consideration, those incentives would be contrary to the 57E purpose. So the Commission didn't ask the right questions. Could these revised thresholds do the sorting, again I think in the light of the questions that Justice Tipping asked me a moment ago, I can be reasonably brief. The answer is that they couldn't because looking at price changed, and even looking for different sizes of price changes, still doesn't tell you anything at each assessment date about whether you're in problem territory or not. Think back to my learned friend's graphs. The fact that the well-performing companies increased their prices faster than that redline was going up doesn't tell you that there's any 57E problem about them. So for at least a third of the population the test doesn't help at all. You needed to ask the question that Justice McGrath asked me earlier. How much has it gone up and has it gone across the green line? That's the key question. That's what would tell you.

Tipping J Well is it simple to say that they weren't diagnostic of excessive pricing and they weren't diagnostic of lack of efficiency?

Goddard Yes, exactly. The Commission would say that they were diagnostic whether companies that were over-charging or inefficient were on track over time to do something about it. I think that's the best that can be said of these thresholds.

Gault J Well that certainly would be diagnostic of a company that after this threshold was set increased its prices to secure excess profits.

Goddard No, because many increases greater than the rate prescribed by this price path would not result in excess profits. That follows necessarily from the graphs, and I could take Your Honour back to those if that would be helpful.

Gault J Well yes I understand what you say, if you assume that there is a position at the outset, but I'm assuming that a company at the outset of the regime is on a normal profitability, normal efficiency path, and increases its prices.

Goddard By more than the rate set.

Gault J Yes, yes.

Goddard Yes, the difference between the revised threshold and the initial threshold in terms of whether you're getting perverse incentives, and whether you are testing for excessive price increases or not, is that instead of the problem applying to the mid-level group and everyone doing better, it now only applies to the people doing better.

Gault J I understand that point.

Goddard Yes, but again if you are saying oh look an increase above this level tells us something useful for a particular group of companies but it doesn't for the others, then in my submission what you've got is not a diagnostic tool for a problem because for a significant part of your population you're asking the wrong question. You know that a price increase faster than this won't be indicative of s.57E concerns and yet you're applying this threshold.

Blanchard J Yes, well it may not be a very good diagnostic tool, but it's hard to see that it's not a diagnostic tool at all.

Goddard And that I think is why the Court of Appeal accepted the argument in relation to the initial thresholds but held that the revised ones were different.

Blanchard J Yes.

Goddard And that I think is why my primary argument in relation to the revised thresholds are firstly that the Commission didn't ask itself the right question, so the fact that this might serve as a sort of diagnostic tool for some companies doesn't rescue it because we don't know what the Commission would have done if it had listed in its key principles table, 'should diagnose', and had tried to set thresholds that achieved both the diagnostic function and the incentive function.

Blanchard J So your primary argument on revised thresholds is your misdirection argument?

Goddard Yes Sir, that's my strongest argument on these and my simplest.

Blanchard J Well primary anyway.

Goddard And the other very important argument on this is that they substantively embody that they carry forward in substance as well as form the initial threshold, because what they do for a company is they say how much have you increased your prices since the 8 August 2001 level. You will have breached the threshold if you increase your prices by more than 0 for 2 and a half years, and then CPI-X after that. So in other words if you ask what the permitted price increase was at the first assessment date under the new thresholds, which was 31 March 2005, the answer is that the permitted increase from 2001 levels was inflation in the 04-05 year, let's say 2.5%, minus the relevant X factor. For Unison that was 0, so the answer was CPI.

Tipping J The base that you've claimed to be ineffective but by dint of no P zero adjustment necessarily applies albeit more indirectly in the revised case as the initial?

Goddard Exactly.

McGrath J Mr Goddard in I think it was in March 2004, the Commission issued a press statement as I understand it, indicating that if you had exceeded the first threshold that wouldn't matter unless you also indicated the second. I may have mistaken that but you'll know the passage I'm referring to. Ms Rebstock refers to it and it's referred to in Mr Dobson's submissions about para.114. I'm just wondering whether this affects your argument about carrying forward the initial threshold. In other words the Commission was signalling but only March 2004, that it was the second threshold that really counted.

Goddard The Commission in its submissions here has clarified what it meant by that statement and one of the things its clarified is that it was only applying that leeway to breeches of the initial threshold while that was in force, and that it was only applying it where the only threshold breached was the initial price path threshold, not where any other threshold had been breached, so when one looks at what the revised thresholds embodied, no it doesn't effect that argument at all because when it came to apply the revised thresholds it was just those that were applied. The CPI-X increase wasn't backdated in any sense to 8 August 2001. Unison asked the Commission to do that and the Commission refused. What the Commission does when it applies for a revised threshold is not affected in any way by that press release. It's not applicable to revise threshold breaches and what it does is test whether you've exceeded a level of price change assessed by reference to your 2001 prices, assuming that those are held constant for two and a half years through to March 2004 and thereafter may increase at the CPI-X rate. Now it seems to me Your Honour that it's hard to imagine that a threshold of that form would have been adopted in the absence of the initial thresholds. So if the initial thresholds are unlawful and therefore you didn't have a legally binding end point in 2004 of the same prices as 2001, no rational decision-maker would assume that a start point for a price path in 2004 was 2001 nominal prices. The reason that was selected was because it was the end point and again I won't go through this in gruesome detail, but Your Honours will search in vain in the revised threshold paper for a discussion of the pros and cons of 2001 prices as a start point in 2004.

Tipping J Yes this is the link between the two that is paralleled by the *Fisheries* case?

Goddard Yes, one is built on the other. The only reason this started from 2001 prices when it kicked off in 2004

Tipping J The Minister's base in the *Fisheries* case was erroneous and that base was carried forward into the second round?

Goddard Yes, exactly, that's the link. It's exactly the same issue. That the reason the Minister set 3,000 the second year in the *Fisheries* case was because that was the prevailing rate. Similarly the reason the Commission has started on 1 April 2004 from the 8 August 2001 prices is because that was the prevailing price under the initial threshold.

Tipping J It would have been alright if it wasn't bad for initial purposes, but that the fact that it was bad for initial purposes is not cured by being adopted for this second round?

Goddard Exactly.

Tipping J Yes I understand the point.

Goddard It is absolutely substantively locked into this. If the Commission had been starting with a clean slate when it made its 2004 decision, if there had been no initial thresholds made, can the Court say with confidence that it would still have taken as its starting point nominal prices in 2001? That in my submission is the test because otherwise the second submission is tainted by the making of the illegal decision. It's effectively a severance.

Gault J Well I have some difficulty with that. Could I have your comment on this Mr Goddard? We assume for the purpose of this discussion that the initial threshold is invalid but it is invalid as a threshold to constitute a prerequisite for control, but does that mean that the value that is taken into the revised threshold is nonetheless not a factual value that could be taken in? It doesn't depend upon the validity of the threshold as a threshold. It is simply a value.

Goddard The value nominal average weighted price as at 8 August 2001 of course exists quite independent of whether the initial threshold was made or not.

Gault J Yes well that's the difference isn't it from the *Fisheries* case?

Goddard No it's not Sir because what was asked in the *Fisheries* case was why did the Minister select 3,000 in the second year, and the answer was because that was the figure set under the previous decision, similarly here.

Blanchard J Yes but here you had a date which was the commencement date.

Goddard And what you had in the revised threshold decision was the Commission forming the view that prices could be expected to increase at CPI-X for the different groups of companies. It didn't say so let's take the prices at the start date of this statutory regime, 8 August 2001, and apply our CPI-X line from that date. It didn't do that. It drew the lines in my friend's graph. A flat-line for two and a half years, then a line going upwards. Now what explanation can there be for a decision-maker finding that the appropriate rate of price increase for an ordinary company – a plain vanilla company – is CPI-1, then setting a price path threshold that doesn't apply CPI-1 from the date on which the regime commenced, but applies 0 for two and a half years then CPI-1 only the fact that it had previously issued an instrument requiring a 0 increase for those two and a half years. I would argue irrationality

Tipping J Well I was just going to say that maybe your better and analytical point – I'm not expressing a view about it.

Blanchard J Exactly.

Tipping J Yes.

Goddard If, out of the blue, not having made the initial decision, the Commission had set a threshold of this form. If it had formed the view that you should expect a well-performing company to increase prices at CPI-1, and had said therefore we will set a threshold that requires a different rate of change for two and a half years, and then suddenly starts

Blanchard J But that's an argument for overall irrationality of the revised threshold. I think you unnecessarily complicate your argument by talking about tainting and using a very technical approach to it. The guts of your argument as it is with the initial threshold is unfitness for purpose.

Goddard Yes.

Blanchard J And this is an element which you say points to unfitness for purpose.

Goddard Yes I'm comfortable with that formulation Sir.

Blanchard J Much simpler. I don't say it's right, I don't say it's wrong either, but I like the simplicity of it.

Goddard For which we all struggle to echo another eminent public lawyer.

Blanchard J But it's why I don't see the fishing case option at all.

Goddard I'm, yes, many years behind Your Honour in that struggle for simplicity and Your Honour has reduced a number of my arguments to much more elegant forms than I've managed to despite that fact that this is the fourth attempt.

Blanchard J Flattery gets you nowhere.

Goddard It was worth trying Sir, but things didn't seem to be getting anywhere.

Blanchard J I like it but I don't buy it.

Goddard Substance was hard so I thought I'd try something else. Where am I?

Tipping J Close to the end I suspect.

Goddard In my note to myself of what I was going to cover today I had suggested that at this point it would be useful to go back over some parts of my full submissions, in particular sections 6, 7 and 8, but actually I think I've

provided the punch-lines from those on the way through and I'd just be trying the patience of the Court if I went around that again. I would ask the Court to look at those again in the light of the review of the decisions and in the light of the argument that the Court heard this morning about what price changes do and don't tell you, because that tries to summarise that point and explain where it takes these things in a much more measured and considered way that I've been able to today. But the Court has had the punch lines of all that and that in terms of the outline I handed up yesterday means that we've covered the first page – what thresholds and the misdirection issues, and on the second the fact that the thresholds are simply unfit for purpose. The incentive function argument that that's also something the Commission didn't properly address and that they can't do. They're just as much perverse as positive, and then the relationship between the two points which Your Honour suggested it could better be put as the revised thresholds being unreasonable, irrational, because they incorporate a nominal price freeze for two and a half years against the backdrop of a conclusion that that's not what companies should actually be doing. I then move on to my third page, para.11, and following to why the price path threshold decision should be set aside. I think that probably takes me into the area of relief that Your Honour indicated I should leave for now.

Blanchard J Yes.

Goddard So unless the Court has any questions about what I've said, I think that concludes my primary submissions on the question of unlawfulness.

Tipping J I have one question Mr Goddard. Conventional cases on fulfilling statutory purpose are cases as per Lord Reid's dictum in *Padfield* whereby he invoked the ideas of thwarting or running counter to. Are there any cases which involve a situation where there's not thwarting or running counter to but simply misfiring or, using my brother's language, unfitness for purpose? I just inquiry of that because at least as far as my memory goes I can't immediately call one to mind. It's normally that it's bad faith or you're using it for an improper purpose. Now unfitness for purpose doesn't immediately equate improper purpose at least at first blush in my mind, that's why I inquire whether you have anything to offer from the textbooks or decisions on this rather unusual sale of goods type concept rather than administrative law concept

Goddard I think my answer to that has two parts. The first part is that what has gone wrong is that the decision-maker has made something completely other than that which is contemplated by the statutory scheme. Those cases are usually dealt with not so much in terms of substantive inconsistency with purpose in *Padfield* terms but in right question terms.

So normally you tackle those cases by saying did they ask the right question.

Tipping J Well they may have asked themselves the right question, but they may have come up with a wholly inefficient or ineffective answer.

Goddard Well if they've asked themselves the wrong question that an end of it obviously.

Tipping J Yes.

Goddard Now are there any cases where a decision-maker has asked itself the right question but has come up with something that simply is not what was to be created, and that's therefore been set aside? I have to say on my feet standing here now, I'm struggling to think of one

Tipping J Well I'm not surprised, because I've had a quick look Mr Goddard and I haven't gone very far, but I just couldn't immediately turn anything up.

Goddard But let me suggest Sir, and this is the second part of my answer, that the answer lies in the comment of Justice O'Regan in para.92 of a Court of Appeal decision. That's in volume 1, under tab 8, page 131 of the case, beginning at the second sentence of 92, 'the effect of our finding in relation to the initial threshold is that the Commission has exercised its power unlawfully'. This is the key bit. 'Its statutory power under s.57G of the Commerce Act is to set thresholds. In fact, what it set were not thresholds at all', and that's my answer that a threshold in this statutory scheme is an instrument that tests for the existence of 57E concerns.

Tipping J What His Honour means are not thresholds within the purview of the legislation. That's implied in his formulation, yes. So the power to set thresholds must be confined to thresholds within the purview of the legislation, so there is in technical terms a misuse, no pejorative connotation, but a misuse of power?

Goddard Yes.

Tipping J If you miss the target altogether?

Goddard Yes, that's exactly right.

McGrath J Is this really an ultra vires argument?

Goddard Yes.

Anderson J Or a rationality. It could be either.

Goddard They blend into each other as so many authorities point out.

Tipping J Your power is to hit the target. Where on the target is within your discretion, but missing the target is a misuse of power?

Goddard And if you don't set out to hit that target at all that's also a misuse of power

Tipping J Oh that's easy, that's easy.

Goddard And even if you happen to hit it that doesn't rescue it.

Tipping J Well that's

Goddard That the important point with the revised thresholds, because I haven't gone in detail through the argument about why they aren't on the target. I've touched on it and said it's basically the same as the initial but with a few more layers, but critically, critically, if you haven't set out to hit the target, it's no answer that you've happened to hit it because you don't know where on the target you would have hit. Whether it would have been the same place or a different place if you'd asked yourself the right question and if you'd aimed in the right direction. There was a brief exchange about applying the proviso in a criminal context yesterday. That's exactly the point. This Court can't form a view on what the Commission would have done when setting the revised thresholds if it had aimed at the right target. It certainly isn't in a position to say that it can be confident that if the Commission had asked itself a different question and had sought to balance the incentive function with the screening function, it would still have ended up exactly here.

Anderson J Well that's just an example of the not quite so fashionable test now of failing to take into account a proper consideration.

Goddard Yes Sir.

Anderson J Dressing it up is asking the wrong question is just a sort of fashion.

Goddard And these things are prone to fashion to some extent and the Courts point out that the labels overlap in any event – different Judges, different Courts, different jurors have preferred different ways of looking at the same thing, and some of mine have been helpful and some of mine it seems have been much less helpful than they might have been and I'm sorry about that but I think with the assistance of the Court the essence of my concerns about each of these decisions has been teased out.

Blanchard J Well I'm sorry we've had to hurry you along a bit but we're very conscious of the time. Does that bring you to the end of your submissions?

Goddard Unless the Court has any further questions.

Blanchard J No I don't think we do. Thank you Mr Goddard. Mr Dobson.

Dobson May it please Your Honours just while my learned friend is moving, overnight, and conscious that we might be short on time, I prepared some short points in bullet point form, and I trust it will be of assistance to the Court if I provided those to Your Honours. May it please Your Honours just very briefly addressing the points that I reduced to writing. There were a couple of aspects affecting the interpretation of the relevant provisions in the Act put to Your Honours by my learned friend that deserved a reply. The first is the invitation that some assistance can be gained from the provisions in part 4 for thresholds when considering what's required of them under part 4A. The Commission doesn't accept with respect that any such assistance can be derived because it sees its role in assisting the Minister if asked in advising on thresholds under part 4 as an entirely discrete part of work from the statutory obligation it has under part 4A. So the bullet points just identify the relevant distinctions that the Commission sees in the different task that would arise. First in part 4, the Commission's role is only to advise the Minister when requested rather than of course the statutory obligation it has imposed directly on it in a part 4A deception. The thresholds themselves, if they're asked for and provided, are designed to assist the Minister in assessing whether goods or services should be controlled. They don't have any trigger to the jurisdiction of the Minister to go on which is common ground as an important aspect in the thresholds under part 4A. There is no requirement to have them at all under part 4, whereas the Commission was under the hammer here to get its initial threshold set as soon as practicable, and that must also influence the different nature of the task. And under part 4 there is no notion that decision on control proceeds from breach, whereas in part 4A of course it is necessary to trigger the jurisdiction to control. And we also make the point that part 4A has this explicit element of incentivising behaviour without control and that's absent from part 4. The second is a new point that my learned friend urged upon Your Honours arising from the terms of s.57HD where my learned friend drew the distinction between the requirement for reasons if the Commission's decision was not to declare control and the absence of an explicit requirement where there is to be control. There are two, which are relatively pragmatic responses to that, because the Commission does not accept that that distinction goes any distance to creating a presumption that if there's a breach then you'll be moving to control. The first is that where the Commission does progress towards control, it has of course to provide a notified intention of its

declaration in order to give interested persons a reasonable opportunity to provide views. Now it doesn't provide explicitly in the statute that that has to be on a reasoned basis, but one doesn't have to infer very much to recognise that if interested parties are to have a reasonable opportunity to express their views, it ought to be in response to the reasons the Commission advances for taking that step, and the Commission's work instanced in this case is included in the case, I give Your Honours the reference there. The decision to give notice of an intention to declare control is an 85 page report which canvases the Commission's view at that stage of the aspects of Unison's conduct that will likely to give rise to s.57E concerns. So when the statute contemplates a process that is moving towards control there is that articulation of reasons at the prior stage. The second is that the Commission really acknowledges there are constraints beyond its own Act which would render it practically impossible to make a control decision which of course adversely affects rights without providing reasons. I don't want to embark on whether administrative law has advanced to the point where reasons are required. It's not necessary to do so, but for example the Commission is regulated by the Official Information Act and s.23(a)(c) of that creates an explicit obligation that the decision is being made which adversely affects rights then reasons for it must be given. So the Commission treats the requirement for reasons as being implicitly on it and an explicit one is unnecessary but perhaps was appropriate for the legislature because if the decision was to be made not to control then the Commission had to justify that decision and Parliament signalled it wanted reasons.

Tipping J Could I just ask, this is a slight side issue but this has been niggling at me Mr Dobson, this word 'intention' to impose controls seems a very awkward one because you've got to have made up your mind before you've heard anyone.

Dobson Well I said yesterday that the phrase used in the statute is likely to give the wrong impression. If Your Honours

Tipping J But is there anything in this that's germane to the matter immediately before us? I rather suspect not.

Dobson No I don't think there is Sir but

Tipping J No it's just a curious

Dobson But when the

Tipping J If you're not suggesting there is, and I don't think Mr Goddard sought to drive anything from this or had intention, I'll just leave the point.

Dobson No

Anderson J It must have been provisional intention subject to the next section.

Dobson Absolutely Sir, yes. I think the point I sought to make yesterday was that to the uninitiated it sounds as if it is very near the end of the process, whereas in fact as the Commission's worked through it, it's really only in the middle of the process.

Tipping J Alright, thank you.

Dobson The next of the points that my note addresses was anticipating the way my learned friend was going to develop the argument he had this morning, bearing in mind this was prepared before I came to Court, that there was an expectation and it was fulfilled in my respectful submission in the way that I've been able to put Your Honours this morning. Trolling through each of the decisions there was an expectation by the challenger here that the Commission had to provide a well-polished acknowledgement of its task, how it had gone about it and the result, which is an expectation with great respect that a Court can't expect on judicial review and nor should the challenger, because of course the product of the Commission's work is with great respect primarily intended for the Court, but for the industry. And so my first point on this is that it's an unrealistic expectation to expect the Commission to provide the answer to the question which my learned friend poses, and that really brings me to the first of the bullet points at the top of page 2 of this note, that whether the Commission's done an adequate job here, whether it has met the statutory purpose, must be assessed by Your Honours on the substance of what's been done, and it can't depend on the form in which it's articulated the recognition of the understanding of its statutory purpose.

Tipping J But it could be relevant couldn't it Mr Dobson to a failure to take into account or direct oneself as to a relevant ingredient in the exercise?

Dobson Well in concept yes Sir, but in practice I would invite the Court to give the sensible latitude as to the form in which the product of the Commission's work has been recorded because it's an iterative process, it's dealing with an industry for which this is a vitally important issue and in which all of the industry has engaged, so

Tipping J But one of the points that weighed with me was this big emphasis on incentives and virtually none or very little on screening

Dobson On the screening

Tipping J Yes.

Dobson Well I'll come to that

Tipping J In 85 pages.

Dobson Yes I'll come to that and invite Your Honours to see the substance

Tipping J Alright, well come to it when you wish.

Dobson But it is important Sir that the Commission make the submission that it is unable to respond to an expectation that will say right, we also have to make sure this screens, this is why it screens, and for the convenience of the Court, have a place where we can tick it off.

Tipping J I would be the last to be too exacting of you, but I want to be shown if you can, that you at least gave it a nod.

Dobson Right, well lets do that because

Anderson J But your point is that it was publishing this for the elucidation of an informed industry and not for the purposes of a Court's analysis.

Dobson Well although the Commission's strike rate on decisions affecting industries of this magnitude and not being reviewed is not very good, an in fact I think it's a zero in the last couple of years. It lives in the perhaps naïve hopes so that it can get on and do the job rather than be constantly reviewed, so you're absolutely right in terms of the audience. But the second of the bullet points we make here is that the evolution of its thinking as to how it's to address the statutory purposes, has been an iterative one, and we do have to go back through the paper. I'm wary of taking Your Honours through all of these references given the shortness of time, but it is in answer to what in my respectful submission is an unrealistic expectation that we should be able to turn to a single page or a series of pages in the final decision that ticks all the boxes. The iteration of the Commission's work on how it was addressing the statutory purpose starts with the initial discussion paper which is back in March 2002. There is a whole chapter addressing the purpose statement and I won't take Your Honours to it but I just leave it with the Court because it's part of the development of the evolution of the way in which the thresholds would address it. There was recognition at that very early stage of simple thresholds, the concerns that they might catch innocent businesses what's come to be known as false positives. There was from the outset a warning about gaming and in this initial discussion document, if Your Honours go to that, you will see the Commission sending a warning to the industry. We appreciate there's a prospect for gaming here and it will be an issue that we need to have in mind. What a price path can achieve in terms of

delivering the A to C aspects of 57E was set out for discussion with the Commission's provisional view, and inviting the industry to respond. What different options would deliver, and if Your Honours had the time to go through it you will see that this notion of a P zero adjustment was on the table from the outset. It was one of the options that might have been pursued and expressions of opinion about that was sought from the industry and this discussion document set out in terms where after each section there are various points questioned, so that it's actually inviting the industry to engage on it. And what is clear is that it's implicit in all of the analyses that if the incentives signalled by the thresholds that were being devised were not met, then companies will be screened, and I've had to put in or out. It could just say will be screen, we could be neutral about which way it goes, warranting further consideration, so that from the first response of the Commission to the statutory task it's been charged with, they're saying right what do we need to do to incentivise? Let's work towards a pattern of behaviour over time which ought to move the industry to more efficient operation on the implicit basis that if those thresholds are not complied with then they will raise an issue about those who aren't complying with them potentially conducting themselves in a way that is consistent with 57E. The next stage of the paper trail, although obviously there is a great deal of work between each of these, was a draft decision paper in January of 2003. Again that's in the material in the case and on this occasion if I could just take Your Honours just briefly to these paragraphs in volume 8, tab 47, if Your Honours please. The first reference I just draw to Your Honours' attention is under the heading on page 1186 of the case on the lefthand page under the heading establishing the X factors. You will see in 8, the commission acknowledges that some lines businesses may have improved their efficiency since corporation, bearing in mind that we have the historical transformation of all of these businesses, and some may find it difficult to sustain previous rates of efficiency improvement. Others may have achieved more modest efficiency gains and could potentially achieve higher gains in the future. Some lines businesses may have passed on efficiency gains to consumers through lower prices while others have not. In price control regimes, regulators typically account for differences in cost efficiency and profitability by making P zero adjustments for each of the businesses. The Commission is of the view that it is not appropriate at the threshold stage of the targeted control regime to make business-specific adjustments. Instead the Commission proposes to segment the lines businesses into three categories. The categories will reflect their differing abilities to achieve cost efficiencies and absorb price reductions'. And then the Commission sets out what was then its proposal for three different X factors of 1, 3 and 5. Considers the lines business currently operating efficiently and earning a normal rate of return should be able to improve its productivity by at least 1% per year over the next five years. The 3 and 5% categories would apply to businesses currently not operating

efficiently and/or earning excessive profits'. And if Your Honours go over to the next page at para.13

Tipping J But just before we do, the problem with that is that they didn't have the three categories at the initial stage.

Dobson No they didn't because as the work developed they appreciated that they simply didn't have enough information to make a responsible discrimination between them and that the better course was to send an expectation on an industry-wide basis, and they did that Sir because all the information they had suggested that that was appropriate at the time. Now, one of the points that my learned friend made on a number of occasions is that an increase in price tells you exactly nothing. Now that has to be with the qualification of absent other information, the change in price tells you nothing, and indeed if we go to Mr Sundakov's affidavit, he says without additional information changes in price don't tell you anything. But all of that line of attack against the Commissions ignores that by the time the initial thresholds were put in place the Commission did know other things which attributed relevance to the rate of change in prices.

Blanchard J Can you expand on that?

Dobson Yes Sir, and if I could start doing so by in parts of the evidence I referred to yesterday there is first the acceptance and urging by the vast majority of the industry that they could continue a pattern of increasing efficiency by continuing the pricing behaviour that had pertained at the time the Commission began its work. The data suggested that there had been a 5.2% reduction in prices in real terms in the two years before the regime began, so what the Commission did know with the industry support, was that a continuation of that pattern was a reasonable expectation for the period to which the initial threshold would apply.

Tipping J It doesn't quite meet the point in my view Mr Dobson and no doubt you're going to elaborate on this

Dobson No, I'd be grateful if Your Honour would just sketch the concern and I'll see if I can.

Tipping J You may have been aware of the general industry stance, the 5.2% reduction in real terms, and you may have had this expectation, but how do you say there was additional information that cured the problem, but increasing price tells you nothing without additional information?

Dobson Because the information about the industry's expectation justified the Commission Sir saying on average, and sure there will be exceptions, but on average the electricity lines businesses industry within New Zealand is

on target to continue improving efficiency at that rate, and that informs the Commission that behaviour inconsistent with that is out of step with what is otherwise a reasonable expectation. Now it may be out of step, the company may take it out of step for pro-efficiency reasons, but it is very likely that some that will be out of step are for reasons contrary to s.57E, so it is a relevant measure.

Blanchard J Can you give us the best reference to the support for that argument in the materials? I appreciate I may be asking you to go over something you've gone over before. Maybe it's easier to give us a reference.

Dobson I apprehend the references in para.26 of our written submissions are a good starting point, but that's a critical question from Your Honour and I would prefer to reflect over lunch so I don't send the Court with too many references. You've asked for the best

Blanchard J I must say I see this as a central point.

Tipping J Yes, me too.

Dobson Yes.

Blanchard J And I want to make sure I understand your response because I am an economic simpleton as is obvious.

Dobson Well with respect Sir it is not as obvious as I've demonstrated in my absence of .. **(laughter)**. Could I come back after the adjournment Your Honours on what's the best

Tipping J Yes because this point, the increase in price per se tells you nothing relevant, is really at the very heart of Mr Goddard's argument.

Dobson It is.

Tipping J So this is a point you've got to meet and feel

Dobson And what I'm endeavouring to submit to Your Honours is that the proposition only holds good if you don't know something else.

Tipping J Right.

Anderson J Or if you have no context.

Dobson Or if you have no context.

Blanchard J I can understand that, but we need a little fleshing out of what the context was and why it supported the view that this was an appropriate move to make.

Tipping J And if there is some evidence on this, ought it to say well Mr Sundakov may say this, and here's the additional information. But he tells you nothing without additional information and where's the additional information, that would be very helpful.

Dobson Alright then. Well the additional information that I did take Your Honours to yesterday was the extent of industry support for CPI-X as the initial threshold.

Tipping J Well with great respect I have to say that that per se without further assistance doesn't seem to me to meet the point, but perhaps we should adjourn and you can then sort of muster your forces on this issue.

Blanchard J Would it be helpful to you if we took the break now?

Dobson Well it may be convenient just to pursue the point Sir because it is certainly fairly fundamental to the Commission that if the industry says we can continue the present level of not increasing prices, the businesses won't say that to the Commission if that commitment in any way disincentivises the future of their business otherwise they would argue for something else. So the Commission can surely reasonably take from that indication that the industry can live with, i.e, can make efficiency gains of the extent that the threshold would reflect and would anticipate. So that is a very important aspect of information which the absence of which would reduce the signal that is sent by somebody breaching a threshold set on those terms.

Tipping J We'll leave it until after lunch Mr Dobson.

Dobson And in terms of information that the Commission had independent of what the industry told it I will come back to you after lunch.

Blanchard J Is it a signal that it promotes the efficient operation of the markets in terms of 57E?

Dobson Yes it is a signal

Blanchard J Or is it merely self-serving?

Dobson You mean self-serving by the industry?

Blanchard J Yes, that's the question I would want to have answered.

Dobson Well it would only be self-serving if in fact they were offering a price freeze if they were fearful of a threshold requiring significant reductions in prices, and the information that the Commission had didn't suggest that that was a concern that needed to be warranted, that it didn't have enough to build in, for example when some of the overseas regulations where they started with this more drastic P zero adjustment, there were adjustments required from businesses of more than 10% at once, but the Commission's information didn't suggest that level of fat in the system, so the Commission was surely entitled to take comfort that the businesses were genuinely saying yes, this is about the right level of ongoing improvement in the efficiency on an industry-wide basis that you should expect, and is appropriately reflected in the threshold.

Gault J Is it correct that throughout this period of discussion with the industry, it early became evident that they were talking about a period of an initial year before the revision was to take place.

Dobson The notion of an initial with a relatively prompt revision evolved in the course of the dialogue. I don't understand Sir that it was the fixed position of the Commission at the outset.

Gault J Right, thank you.

Dobson I'll come back on the non-industry information available to the Commission after lunch if I may. May it please Your Honours.

Blanchard J Yes, thank you, we will take the adjournment.

1.03pm Court Adjourned
2.16pm Court Resumed

Blanchard J Yes Mr Dobson.

Dobson Thank you Your Honours. In terms of the evidence available to the Commission, I am grateful I was able to pause in the middle of that. I was going to consider going away from the document we were considering but apprehend it's most efficient if we stay with it, so if I could take Your Honours back to the point we were at before lunch where I had asked Your Honours to go the draft decision of 2003, volume 8, page 1186. I think I had taken Your Honours to para.9 about what the situation is in price control regimes. Mention of the debate on whether a P zero adjustment is appropriate in a threshold context, and then in para.10 the proposal at the

stage for three different factors. We come across then to para.13, and Your Honours will see the little marginal summary of it. The Commission has considered a range of information relevant to setting X factors. And the body of that paragraph, 'the Commission has considered evidence from New Zealand, including the efficiencies achieved by lines businesses in recent years as well as information from a study of New Zealand productivity prepared for the Treasury, Reserve Bank and Department of Labour. The Commission has also considered the price paths set in overseas jurisdictions as a check on its analysis of New Zealand information'. And then under the heading above 15, productivity growth in New Zealand, it goes through the reference points that were then available in terms of relevant information. If I can bring Your Honours over to para.18, you will see the summary of that paragraph reflects economy-wide productivity; growth has been about 1 or 2% per annum. And the detail of that in the second sentence the most relevant period is that between 1993 and 98. It shows the TFP which is the total factor productivity is estimated to have grown by between 1.17 and 2.38% per annum. There are estimates of TFP growth over the 20 year period between 78 and 98, the period show a trend TFP growth rate of between .58 and 1.56%. And then in 20 the differentiated information about the utility of the New Zealand economy, there little summary says productivity growth has been about 4% and there's their reference to the study of Diewert and Lawrence, and that Lawrence I can confirm for Your Honours is the same Dr Lawrence who runs the *Meyrick and Associates* who were after an international search and open process for consultants on this, they were chosen to do the work that we've heard so much about. Provide sector estimates of TFP performance. The most relevant sector is electricity, gas and water. Sows annual TFP growth of 3.5% from 78 to 98 and 4.08% from 86 to 98. Using production-based gross domestic product indices, annual TFP growth of 3.5% from 78 to 98, and 4.08% from 86 to 98. Using production-based gross domestic product indices, annual TFP growth was about 4.7% over the period 93 to 98. This indicates strong and consistent productivity growth has been achieved in the sector over lengthy periods of time particularly in the most years recorded in the study. And then this commentary reflecting on the information gets more specific, just down to lines businesses, and in para.21 you will see the marginal note, some lines businesses consistent with an X factor of 2-3%. And on what the information they had about lines businesses, the paragraph comments that some lines businesses appear to have reduced costs while holding constant in nominal terms for extended periods. Given past inflation rates, this implies the lines businesses may have achieved annual productivity improvements in the recent past in the order of 2 to 3%. So this is the context of information which the Commission was taking into account in deciding the form of the X-factor in the initial thresholds. If I could just take Your Honours across to the next page, to the summary on the righthand part of the next page and I won't go through

it but I just draw Your Honours' attention to the little summary again in the margin 'overall the evidence suggests annual efficiency gains relative to CPI of between 1 and 5% are possible. So this was the Commission signalling at the time of the draft decision what its expectation on industry-basis was. Before I go forward I'd be grateful if I could just take Your Honours back to the initial discussion paper which is referred to in the prior paragraph of the written paper I produced just before lunch, because I'd like to invite Your Honours to add one reference, and indeed it's important enough to ask Your Honours to go to that which is in volume 4 at tab 23, bearing in mind, and I'm sorry I didn't have this reference when I was dealing with it chronologically. This takes us back to the initial discussion paper in March 02, but

McGrath J Sorry what volume is this at?

Dobson I'm in volume 4 now thank you Sir.

McGrath J Thank you.

Dobson The page I wish to take Your Honours to is page 494, which is at the beginning of a chapter devoted to threshold design and Your Honours will see in para.7.3 the Commission's view at this early stage of what the purpose of the thresholds should be and just in terms of this iterative process and what the industry would understand the later evolution of it to be, I draw Your Honours' attention to 7.4 'the thresholds are designed to identify which businesses are not achieving these outcomes themselves. Thresholds, therefore, set standards against which businesses can measure their own performance so they can see whether they need to improve if they are to avoid investigation and the possibility of control. Thresholds that facilitate self-assessment increase certainty and are likely to lower compliance and administration costs'. So in my submission that's part of the iterative process building up the two elements of incentivising and screening. Now just returning to the bullet points I tendered to Your Honours, before we go on to the decision paper could I just invite Your Honours to reflect on the chronological sequence – the decision paper that I took Your Honours too is January 03 and the decision paper is June 03, but between those two pieces of work a consultation was ongoing. There was consultation on the draft decision paper and then cross-submissions and that's dealt with in paras.74 to 119 of the *Gunn* affidavit, so Your Honours will find that, and I don't intend to go through all that passage because it draws in some of the more pertinent submissions that were received. That is in volume 2 under tab 14. It starts at 215, page 215 and continues through to page 229. I'd invite Your Honours to especially reflect on para.76, if I could just give you these references and I'm sorry they weren't in the note that I provided. 76, 86 to 88, 91 to 93, 95 to 96, and 98 and 99, because that's gathered together in one place, and is a

pretty fair summary of what the industry said in response to the draft decision paper and the evolution of the Commission's thinking up to the decision paper. The decision paper itself is in volume 3 and I would like just to go to one page in that under tab 20, page 334. Now this is the executive summary that my learned friend took Your Honours to but in reflecting on it what I invite the Court to do is appreciate the place it had in the initial process. It's not to be tested for its adequacy of the consideration of screening or incentivising functions just on its own, it needs to have all of the background that preceded it taken into account, and indeed the iterative process is recorded in that executive summary so that's a pretty fair hint that the Commission expect the reader not to come to this cold but to appreciate the part that the background has played in it. In the, and of course there is the explicit acknowledgement near the foot of that page that thresholds are a screening mechanism to identify lines businesses whose performance my warrant further investigation and if required control by the Commission. Just a minor correction I've noted in the note that Your Honours have got that the letter from Unison my learned friend tendered to the Court yesterday dated May 2003 I think he described as being provided before the decision, but the passage that I've just taken Your Honours to in the decision acknowledges it, so it's a re-issuing of it and it was first issued before the 29 May letter from Unison.

Tipping J You mean the decision was made before receipt of that letter?

Dobson Yes. My learned friend makes the technical point that the decision is the issuance of the Gazette notice. I am talking about an earlier form of the reasons document which had been available to the industry in May. Now if I could come back to Your Honour Justice Tipping's question well what's the quality of the information, the passages I have taken you to really encapsulate what the Commission had to rely on as the context in which it considered that appropriate incentives would be created and an appropriate screening-out or screening would result from non-compliance with the X factor of CPI-CPI in the initial threshold.

Tipping J So your submission is (a) that they did regard that that as being appropriate from the incentive and screening point of view and (b) they were entitled to that view?

Dobson Yes Sir, they were entitled to take that view because on the best information available the threshold which set out an expectation of pricing behaviour could be reasonably expected to screen companies which didn't comply with it as being likely to demonstrate conduct inconsistent with a purpose statement. Now although it's referred to as the last of the points in the note, perhaps it's easiest to deal with the next point I wish to make in response to the oral submission my learned made this morning which was that there is no evidence that change in price helps in identifying the

conduct contrary to s.57E, and I think my learned friend made the submission that all the evidence is the other way. Before weighing that submission I'd invite Your Honours to go to the affidavit of the Chair, Ms Rebstock, which is in volume 2 under tab 15. I just note in passing that the Chair makes the point that the effectiveness of the regime can't be measured solely in terms of the consequences for one individual business, and certainly as this challenge began there was an aspect of that. I don't that in fairness my learned friend puts the case for Unison before Your Honours in those terms but that's a fact which in my respectful submission must be right, that if there is one business that's behaviour is abhorational and which would tend to prove that the threshold for example doesn't screen then that doesn't make out the case that it's not otherwise and effective or a sufficient screening mechanism, but the particular paragraphs on the evidence of the relevance of change in price are those at 15 and 16, page 274 of the case. Ms Rebstock said in 15 that 'he preliminary view that is about the utility of CPI-X price path threshold was reinforced through consultation with interested parties. Price is one of the simplest objective measures of performance. Price changes are clearly a relevant consideration in designing a set of thresholds and lower prices for consumers is a key objective of the targeted control regime. The Commission is aware that not all price increases are inefficient or signify excessive profits. Nevertheless in most markets where there is competition there are ongoing improvements for consumers in price, quality and choice'. And she then relates that observation to the CPI price path in the next paragraph, saying that 'it provides a mechanism for potentially mimicking the price changes that result from competitive market pressures'. So that if the initial threshold is seen as the starting point when the Commission knows that it can reasonably expect the industry to continue with its relative improvement and efficiency that's reflected in the data available to it, then pricing behaviour inconsistent with that expectation is going to raise a material flag about conduct that may be inconsistent with s.57E.

Tipping J In Mr Sundakov's – is it Mr or Doctor Sundakov?

Dobson I think he's Mr Sundakov Sir.

Tipping J In Mr Sundakov's affidavit, is it correct that his thesis was that price changes per se in a vacuum are not helpful but price changes in a context can be helpful? I think that's what I understood from, is that a fair reflection of his evidence, that once you bring in a context then they may be able to shed the light on the issue concerned?

Dobson Yes, and Mr Sundakov's hypothesis is that that context requires you to identify a company-specific relevant starting point.

Tipping J Yes, that's the P zero.

Dobson P zero.

Tipping J Yes.

Dobson And it's on that point and the extent to which that actually becomes a proxy for assessing control that after considerable debate the Commission did not debate and went to the other form of

Tipping J But your answer essentially is that we have here not just bare price movements but against a known background.

Dobson Against a known background and of course past performance in the industry is about the best predictor that the Commission could have of likely future performance, and the submission I endeavoured to make yesterday is that the price path it set was a responsible reflection of an expectation of what would happen in the future, based on its knowledge of what had happened in the past.

Tipping J Thank you.

Dobson I've now got to the end of the matters that I had the opportunity to summarise in writing and if I can move subject to direction from Your Honours through a limited number of points dealing with them chronologically in the order in which my learned friend made the submissions to the Court. He made the submission this morning that undoubtedly the thresholds have prevented beneficial movement in prices. Now that's not a proposition which the Commission would accept. There's no evidence of that. What there is evidence of is that by the time the *Meyrick* analysis revealed the various components for the C1 and the C2, that there were companies who ought prudently to be increasing their prices over time. But with great respect that's an entirely different notion from suggesting that the thresholds have prevented beneficial movement. For one thing sudden price changes, whether they be up or down, are likely to have adverse affects. If there is a sudden P zero adjustment forcing prices down suddenly, that's likely to have a disincentive in the long term, and even in a monopoly there are adverse consequences of a price shock for consumers, and it must be in the interest of the long-term benefit of consumers that they be protected from radical changes in price, which is I understand in my learned friend's submissions this morning about the companies that haven't been charging high enough ought to be permitted of them. As to the troublesome analogy about overweight children, I would respectfully adopt the way that was treated by Justice Wild at para.121 of his judgment and I'll say no more about that. The next response I wish to make to Your Honours is on what one might call a

qualitative criticism of the Commission which was that if I understand correctly my learned friend would have the Commission have not set a threshold at all until it had data of the specificity that the *Meyrick* analysis provided for it, but that he would then have had them use that data in a somewhat different way. Now it's unclear to me whether in saying it doesn't need to be a full P zero adjustment but it could be some rough cut, quite where that Unison's case because if it's not a company specific P zero adjustment then it does fall very much to the relative banding on productivity and profitability which the *Meyrick* analysis produced, and if the X factor has reflected the product of that, then in my respectful submission it should follow that what the revised threshold did fits Unison's requirements. In terms of the amount of work that is required, Mr Sutherland, the CEO of Unison in some of his evidence to the Commission, acknowledged that the sort of work that Unison contemplated by a P zero adjustment might take up to 18 months to two years to complete, and the quote from his evidence Your Honours is at paras.51 to 53 of Dr Gunn's affidavit. And I appreciate it's not for my learned friend to tell the Court what the threshold ought to have looked like, but just in testing the credibility of the criticism that it didn't meet the statutory purpose, in my respectful submission the Court has to take into account how realistic the extent of work that that sort of threshold design would require. A short point I wish to respond to is my learned friend's submission that this wasn't a case where it was better to do something than nothing at all and that the Commission should have desisted until it could produce a threshold which on Unison's view is consistent with the statute. With great respect, and I don't want to repeat the point, but that must ignore the extent of information that the Commission did have about the industry, and his criticism only avails if any threshold had to relate to a company specific analysis, because that's really where the division lies, and it's obviously the case for the Commission that a set of thresholds can promote the statutory purpose without being preceded by a company specific analysis. I think my learned friend was inclined to liken the Commission's dialogue with the industry with the telephone call that the Minister cited in the House, and with great respect they aren't similar at all. The Commission proceeded in a very measured way, taking into account everything it could glean about the industry before moving, not just simply asking are you happy to live with a simple constraint on prices. Now coming to the adequacy of the initial thresholds, my learned friend made the submission to Your Honours a little after midday specifically related to the documents, but I apprehend intending it to be a criticism of the whole of its work. Nowhere does the Commission ask, who will this catch? Are those people likely to raise s.57E concerns? And the answer to that is yes, the Commission was asking itself that question and the answer was yes, those who don't conform to this expectation are likely to raise s.57E concerns because their pricing behaviour will be inconsistent with the glide path of prices that all the information we have tells us is

appropriate for this industry. The second question which he posed and said that the Commission didn't ask itself was are the people we don't catch likely to behave, and in my submission the initial threshold provided the beginning for answering that question as well, because over time conduct that continues to remain consistent with the threshold would be procuring changes in behaviour, that would mean on my learned friend's terms, the companies were behaving. In my respectful submission there is ample evidence before the Court that the work undertaken by the Commission leading to the initial thresholds embraced those questions before my learned friend proposed them and they are adequately answered. Now in my learned friend's argument challenging the revised threshold, he submitted to Your Honours that it's hard to imagine a threshold of the form that it took would have been chosen but for the initial threshold. And there are two answers to that. The first of them reflects the nature and extent of the work that the Commission did and this is addressed in paras.16 to 20 of the Commission's submissions going to relief because the process between the initial thresholds and the revised thresholds included a fresh round of consultation. Questions asked included, and the reference is given in para.17 of that second set of submissions, do the average prices at the first assessment date provide the most relevant starting price for the CPI-X price path to be applied from 2004. So the Commission put in issue the whole of the design and there wasn't any slavish adoption merely because it was there in the initial of the starting price that had been used in that and I won't take Your Honours through that submission which was prepared for a different context, but in terms of my learned friend's submission, that is the answer to it. And the second aspect to this point is that the *Meyrick* work reflected the pricing conduct by the companies and the analysis undertaken by *Meyrick* suggested that the appropriate starting price happened to be the one that had been used in the initial threshold, but that was a reflection of the conduct of the companies in the interim, not because it was the number that had been chosen in the initial threshold.

Blanchard J Have you got a reference to that?

Dobson To the *Meyrick* work Sir?

Blanchard J Yes.

Dobson Yes I can get that for Your Honour. I'm grateful to my junior who suggests page 891 Your Honour, which means it's in the *Meyrick* report.

Blanchard J Volume?

Dobson Volume 6 under tab 29

Tipping J What was the page again Mr Dobson?

Dobson Page 891, thank you Your Honour.

Tipping J 891, thank you.

Dobson What we've got there is the consideration of the C factors for the period. I don't apprehend Sir; it's the best answer to Your Honour's question as to why they satisfied themselves that this same starting date should be used

Blanchard J Yes, that's what I'm after.

Dobson It may take me a moment longer to find that. Sorry Your Honour but I may have to come back. I'm sure it's referred to somewhere in here but I'm just seeing so much paper.

Blanchard J But where do they say in here that the appropriate starting point is the one used in IPPT?

Dobson I'm sorry Your Honour, I may have to put our reliance on *Meyrick* for that proposition because I can't find it, I'm sorry. What we do have in here is the tracking of their behaviour over the period that included that that had applied since 2001, and

Blanchard J Yes but with *Meyrick* simply taking the IPPT as a given – I appreciate there doesn't seem to be evidence that the whole design was put in issue in terms of consultation, but was that in fact the position that *Meyrick* were in, or were they merely asked to move forward from the initial position?

Dobson I think they were asked to move forward but the point is that

Blanchard J Oh I'm glad they were asked to move forward.

Dobson I don't seem to be able to, I'm sorry Sir, but from the position that had pertained under the initial, but the period of conduct that they surveyed included the period between 2001 and 2003. So to the extent that their data reflected the behaviour of the companies in that period, that confirmed the appropriateness of building an expectation for the future on prices in the 2001 to 2003 period. And I don't apprehend I can take anymore out of their work than that, and if I put it any higher than that then I don't seek to sustain it. So Your Honours that gets me to endeavouring to answer Your Honour Justice Blanchard's proposition about fitness of purpose, and if we go back to the beginning of what's involved in that and in my submission when you ask fitness of purpose we must first determine what the purpose is and if the purpose is as the Commission contends, the thresholds are to both incentivise and screen.

In their screening respect they will be fit for the purpose. If they identify it for further consideration, companies that are likely to give rise to concerns about conduct that is inconsistent with the purpose statement, and it's our submission that the thresholds will be fit for purpose if their design admits of the prospect of some false positives because on the continuum from barely adequate to overly sophisticated, one has to go so far to the overly sophisticated end of the continuum to eliminate all prospect of false positives as to give rise to a concern about the utility of the thresholds as one component of the whole regime. And subject to questions for Your Honours as to why that might not be an adequate description of what's fit for purpose, those are the points I make in reply.

Tipping J Could I just ask one thing Mr Dobson? Do you have anything to offer on this question of, this thwarting question if you like, that I asked Mr Goddard at the end? I think I ought to be even-handed and ask you too. You understand the point I'm making?

Dobson Yes I do.

Tipping J Yes.

Dobson And essentially I agree with your analysis with respect. I've got to accept what my learned friend says that the tests for unlawfulness do overlap. I had thought that Your Honour was teasing, not teasing in a literal sense, but you were drawing my learned friend to a test of unreasonableness which seemed to be the one head of challenge that he didn't contemplate, but certainly on the *Padfield* test and the way that the Commission was required to answer the case as pleaded against it, it's my submission that it is in effect a negative test and it fails to promote the statutory purpose if it frustrates it, and my learned friend relies on an extract from *Fordham* which puts it just in those terms, so

Tipping J But what if it simply doesn't achieve anything. I wouldn't have thought that was *Padfield*, it may be something else.

Dobson I agree, yes Sir, and that's why I suggested that we might be getting to unreasonableness, because if the Commission has a power to do anything on the continuum, and it simply misunderstands the effect of what it's putting in place, so it's just off the end, then that in some context might be an unreasonable exercise of the statutory power to set the threshold.

Anderson J It depends also on the consequences. See you might come up with a formula that is wholly neutral in terms of the effect but compliance with it involves cost or inconvenience to the people being controlled, so you then get interference with their business with no purpose being served.

Dobson Yes thank you Your Honour but put more positively that surely goes to the breadth of the discretion the Commission has because it has to be mindful of this being thresholds targeted to control statutory recognition that it is likely to be inefficient to control the whole regime, the whole industry.

Anderson J Well it's a question of looking at beneficial and non-beneficial effects and that maybe you have to get to the point of absolute 'no-hoper' formula with some impact before it reaches the state of repugnancy.

Dobson Before it falls outside; yes I'd accept that Sir, yes.

Anderson J Otherwise it's difficult for a Court which is not a specialist Tribunal in the commercial sense to evaluate the beneficial and non-beneficial effects and weigh them, which might very well be a matter of policy.

Dobson I accept all of that Sir, yes.

Blanchard J Yes thank you Mr Dobson.

Dobson May it please Your Honours

Blanchard J Well we're going to take a few minutes to adjourn and have a brief discussion about where we might or might not have got to and I think before we do however, could I ask counsel, and I appreciate it may be difficult to give any definitive sort of answer at this stage, that if we do decide that we need to hear from counsel on relief, how long realistically is that going to take? Are we looking at half a day; a day? Bearing in mind that we wouldn't want to see the process rushed.

Dobson Well I shall sit down I think

Blanchard J Bearing in mind that we wouldn't want to see the process rushed.

Dobson I'll sit down Sir. I think it's probably a question for the defence more than me.

Blanchard J Well you're going to have to respond aren't you?

Dobson My contribution may depend on what they say.

Goddard If past performance is a guide to the future, he'll be longer than I will Sir.

Blanchard J Well not by much.

Goddard Which I think was a large part of his case, though not by much. But I think half a day plus says

Blanchard J A day.

Tipping J Oh not half a day, not a hope. It has to be at least a day.

Blanchard J Maybe I shouldn't have asked you, I should have just asked Justice Tipping.

Tipping J I mean really we have this problem all the time. People are so astray in the length of time. You've got to allow for quite a lot of intervention by the Court, particularly in difficult areas like this.

Goddard I think that's where I've gone astray because the dynamic in this Court is very different from other Courts, and appropriately so, and I think that's one of the reasons why we've all under-estimated the time required for this hearing for example, and the amount of time each us would require so yes, I think Your Honours are right, I'm confident we can do it in a day.

Anderson J But it's no more difficult to schedule a day than half a day, but it can be difficult to schedule two days instead of one.

Goddard No, I'm confident it can be done in a day. If I am trying the Court's patience I'm sure Your Honours will tell me but Justice Tipping asked me on the spot for some case references about this thwarting point before and I did have a quick look over lunch and I do have two references that might be helpful. Can I just deal with that?

Tipping J If it helps. Just the references.

Goddard The references were to a number of the local authority rate resolution cases, because sometimes the resolutions

Tipping J Well I don't think you're entitled to any narrative - I think you just give us the case references Mr Goddard.

Goddard Okay. *Potts and Invercargill City Council*.

Anderson J Who?

Goddard *Potts and Invercargill City Council.*

Anderson J *Potts*

Goddard *Potts*. It's under tab 24 in the casebook. And one of Your Honour Justice Tipping's cases, *Westland County Council and Greymouth Harbour Board*.

Tipping J That's a ghost from the past.

Blanchard J It was probably your father.

Goddard And Your Honour found that it wasn't a resolution within the meaning of the relevant statutory provision.

Blanchard J Is that in the book?

Goddard Yes it's in the book, it's under tab 39. I would also like to provide one reference in response to the Court's question of evidence of what the Commission expected with respect to proactivity gains. No narrative, just the reference, and it's to a paragraph in the document my friend went to. Case volume 8, tab 47, page 1186, para.10, where the Commission said it could expect 1%.

Blanchard J Well don't tell us about it.

Goddard That's the particular sentence. The sentence where the Commission says it expected 1% and that's all Sir.

Blanchard J Mr Galbraith I apologise for the long wait you've had but you no doubt expected it would be fairly lengthy. Do you agree that it would take no more than a day?

Galbraith Yes Sir I sure it would Sir, but it will take more than half a day.

Blanchard J Yes. Mr Dobson?

Dobson I apprehend that it might be a little longer. One way of dealing with the issue is if Your Honours were on the unlawfulness able to

Blanchard J To say whether it was one or two.

Tipping J Or none.

Dobson Or none.

Blanchard J Well if it's none we don't

Dobson If another problem goes away in a sense Sir if we do have to, and I haven't had a chance of talking to my learned friends about this, but if we have had to truncate the hearing, might it not be better for us to invite the Court to provide a judgment on the unlawfulness and time to reflect on it? I'm sure the Commission wouldn't be obdurate if there was a finding it's made a

fundamental mistake. Having said that if the outcome is the same as it was in the Court of Appeal then there are a range of arrangements that the Commission would want to be heard on entitlement to relief and the discretion.

Blanchard J Yes, well I can understand that but Unison and Vector of course are wanting to get a decision as soon as possible because they've got arrangements in place which they say are costing them the earth in the meantime. Also the Court doesn't want to be under pressure to produce reasons for a decision. Consequently it might be better, and we'll have a talk about this when we adjourn, to try and fix a date for a day and a half perhaps in August if we can find a slot.

Dobson With great respect if that has to be the sequence and we're coming back without an indication from the Court, I would be more comfortable if we allowed a day and a half.

Blanchard J Alright, well we'll adjourn for a few minutes if counsel wouldn't mind waiting.

Dobson May it please Your Honours.

3.04pm Court Adjourned
3.19pm Court Resumed

Blanchard J Well we have decided that the most appropriate course is for us to prepare a judgment on the question of unlawfulness. In other words a judgment on what we've heard up until now and deliver that judgment in due course. We appreciate that we need to get that out as soon as possible that it will be with all deliberate haste, and then if necessary we'll come to the question of relief and have a fixture for the argument of that, but we don't think it's appropriate to rush things. You know we understand the ongoing situation. We'll now adjourn.

3.20pm Court Adjourned