

Memorandum of advice

To Transpower New Zealand Limited

From Mark Toner and Edward Willis

Date 20 December 2013

Subject **Public law analysis of the Commerce Commission's draft information disclosure determination**

Introduction

- 1 You have asked us for our opinion on the Commerce Commission (**Commission**)'s *Transpower New Zealand Limited Disclosure Draft Determination (Draft ID Determination)* and the associated reasoning contained in *Information Disclosure Requirements for Electricity Transmission and the System Operator: Transpower New Zealand Limited: Reasons for Draft Decision (Draft Reasons Paper)*. In particular, you have asked us to analyse the Commission's proposed information disclosure (**ID**) requirements, and the reasoning provided to justify those requirements, from a public law perspective.
- 2 We understand that our views may be put to the Commission as part of Transpower's formal submission on the Commission's Draft ID Determination.

Summary

- 3 In our view, the Commission has failed to take into account adequately the specific regulatory context in which Transpower operates. This failure potentially leaves the Draft ID Determination vulnerable to challenge on standard administrative law grounds.
- 4 Transpower is the most closely controlled regulated supplier under Part 4 of the Commerce Act 1986 (**the Act**) due to the application of the Individual Price-Quality Path (**IPP**), and regulatory initiatives undertaken by the Commission and the Electricity Authority (**EA**). This unique regulatory context is relevant to the Commission's decision making when determining ID requirements for Transpower for two reasons:
 - The purpose of ID regulation is to ensure that "sufficient" information is "readily available" to interested persons. Given the unique nature of Transpower's wider regulatory context, it is arguable that sufficient information is already readily available.
 - ID regulation is intended to achieve the purpose of Part 4 of the Act by indirectly incentivising Transpower to behave in a way that promotes workably competitive market outcomes. As other regulatory mechanisms closely control Transpower

investment and pricing decisions in a manner consistent with the promotion of the purpose of Part 4, the incentive properties of ID regulation on Transpower may be redundant.

- 5 We also consider that the Draft Reasons Paper does not present a clear view on the nature and purpose of ID regulation, or offer an adequate justification for many of the specific ID requirements the Commission intends to impose. In particular, the Draft Reasons Paper does not appear to articulate a logical connection between the level of detail required to be disclosed and the satisfaction of the Commission's statutory requirements.
- 6 In addition, we consider that there are two minor points where it appears the Commission's intention does not appear to be accurately captured in its draft ID requirements or Draft Reasons Paper. It would be useful to seek clarification from the Commission on these two points.

Broader context a mandatory relevant consideration

- 7 In our view, the broader regulatory context in which Transpower operates is sufficiently distinct from other sectors subject to ID regulation to be a mandatory relevant consideration for the purposes of determining particular ID requirements for Transpower.
- 8 From a regulatory perspective, the context in which Transpower supplies regulated services is unique:
- (a) Transpower is the only regulated supplier subject to an IPP. The IPP closely controls many Transpower decisions that ID regulation would otherwise influence. For example, total revenue is capped, which places a direct limitation on Transpower's ability to extract excessive profit (consistent with s 52A(1)(d)). Given that a concrete limitation on the extraction of excessive profits is such a direct consequence of the IPP, the need (or indeed, the ability) of ID regulation to further that objective is unclear. Further, IPP regulation is Part 4-consistent, and so the controls that the IPP imposes on Transpower go to the very purpose ID regulation is intended to achieve.
 - (b) Transpower is required to obtain individualised approval from the Commission for major capex proposals, in accordance with the *Transpower Capital Expenditure Input Methodology Determination (capex input methodology)*.¹ Transpower is the only supplier regulated under Part 4 that is subject to this direct regulatory oversight. This provides the Commission with an unparalleled level of transparency and approval over Transpower's capex.
 - (c) The obligation upon the Commission to consult with interested persons (including, potentially, through a conference) in relation to a capex proposal² provides a high level of transparency and opportunity for input by interested persons. Disclosure of

¹ NZCC 2/2012 *Transpower Capital Expenditure Input Methodology Determination* January 2012.

² NZCC 2/2012 *Transpower Capital Expenditure Input Methodology Determination* January 2012, Part 8.

capex information to interested persons under ID regulation may therefore serve no useful function in terms of promoting the purpose of Part 4.

- (d) Transpower is subject to a number of reporting and monitoring requirements to the Commission. Transpower is also subject to a number of EA requirements to prepare and disclose relevant information. The incentive effect of these requirements may mean that further (public) disclosure is redundant.
- (e) Transpower is the only supplier of electricity transmission services and the only system operator of the national grid. While previous Commission determinations concerning ID regulation have been designed to enable comparisons between regulated suppliers in the same industry,³ comparisons of this nature are not possible in Transpower's context.

- 9 The Commission is required to afford meaningful weight to this regulatory context. Affording appropriate weight to the wider regulatory context ensures that ID regulation has meaningful incentive properties, and is not redundant in terms of promoting the purposes of Part 4. While the Commission has sought to align the proposed requirements with Transpower's other regulatory requirements,⁴ it appears to have only attempted to avoid overlap between the various disclosure requirements Transpower is subject to. A genuine consideration of the regulatory context that discharges the Commission's administrative law obligations would include consideration of the functional overlaps between ID regulation and other forms of regulation, and how those other requirements affect the purpose, scope and incentive properties of ID regulation. In our view, there is no evidence in the Draft Reasons Paper that the Commission has undertaken this necessary functional analysis.
- 10 In forming this view, we have taken into account the recent judgment of the High Court in *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289. In that case, Transpower appealed to the High Court against the Commission's cost of capital input methodology determination on the grounds, among other matters, that the Commission failed to adequately take into account Transpower's individual circumstances, including its unique regulatory context. The High Court dismissed Transpower's appeal.⁵
- 11 In our view, that case does not stand for the general proposition that Transpower's unique regulatory context is not a relevant consideration for the purposes of the Commission's decision making under Part 4 of the Act. Indeed, the Court took the view that the Commission had appropriately taken account of Transpower's individual circumstances,⁶ and in that respect supports our analysis. In addition, the focus of the Court's analysis was the Commission's input methodology determinations, rather than the context for 'operative' regulatory determinations issued pursuant to s 52P of the Act. In our view, the relevance of

3 See, for example, the *Information Disclosure (Airport Services) Reasons Paper* (December 2010) in which the Commission had regard to "ensuring consistency of data, both between airports and over time, to promote comparability of performance and therefore more meaningful assessment" (at [2.37]).

4 Draft Reasons Paper, para [B3.2].

5 *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289 at [1164]-[1168].

6 *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289 at [1168].

the wider regulatory context becomes all the more acute once the Commission's decision making turns from input methodologies to operative 'output' regulation.

“Sufficient” information should be considered consistently and in its context

- 12 The Commission is required to ensure that “sufficient” information is publicly disclosed.⁷ The term “sufficient” is not defined in the Act.
- 13 In our view, the best interpretation of “sufficient” is as an upper limit on the information in respect of which the Commission is permitted to require disclosure. The Commission has broad discretion in respect of the information that it may require is disclosed, and so “sufficient” is the only express statutory indication of a limit on the exercise of that broad discretion. In our view, if “sufficient” had been intended to represent a minimum threshold, an alternative statutory formulation would have been employed. For example, the formulation “necessary or desirable” is used elsewhere in the Commerce Act where a minimum threshold that does not restrict the scope of the Commission's broad power is intended.⁸
- 14 This interpretation places the burden of justification on the Commission to show that existing sources of information are insufficient to form the basis of an assessment of whether the specific Part 4 purposes are being promoted. This assessment must take into account the limited power of ID regulation in light of the more heavy-handed regulatory measures that already exist.
- 15 The Commission does not appear to have undertaken the necessary work of justifying its proposed ID requirements in these terms. In fact, the Draft Reasons Paper does not present a consistent view of the Commission's interpretation of “sufficient”. In some parts of the Draft Reasons Paper, the Commission appears to interpret “sufficient” to mean any information at a level of detail that any interested person would fully understand. This line of argument is used in particular as a justification for requiring disaggregated information.⁹ We consider that it would be difficult to sustain an argument in favour of this interpretation given that it is unlikely that “sufficient” is intended to establish a minimum threshold.
- 16 At other points the Commission justifies certain disclosures as being “useful”,¹⁰ “important” or “of assistance” to interested persons.¹¹ These alternative thresholds all appear to lower the burden of justification on the Commission in respect of particular ID requirements, and are potentially open to challenge on that basis. Information that is “useful” to interested persons, for example, may go well beyond the scope and detail of information that is “sufficient” for the purposes of ID regulation. Identifying particular information as “useful”,

7 Commerce Act 1986, s 53A.

8 See, for example, Commerce Act 1986, s 98.

9 For example, Draft Reasons Paper, para [2.16]-[2.17].

10 For example, Draft Reasons Paper, para [2.20].

11 For example, Draft Reasons Paper, para [4.25], [4.40].

therefore, does not discharge the burden of justification placed on the Commission by Part 4.

Justification of specific disclosure requirements

17 Against this broader public law context for the Commission's decision making, there are a number of requirements in the Commission's Draft ID Determination which we consider merit specific comment:

- (a) *Disaggregated financial information*: The need for disaggregated information (and sometimes multiple versions of disaggregated information) does not appear to have been adequately justified by the Commission, particularly in relation to the cost to Transpower of preparing and disclosing this detailed information in the specified form. The basic questions at the heart of the Part 4 purpose statement appear to us to be adequately addressed with high-level disclosures on regulatory parameters such as the ROI and the RAB. If the Commission considers that the disclosure of further information is required to satisfy the purposes of ID regulation and Part 4 more generally, then it faces a high burden of justification that cannot be satisfied with cursory or generic references to the governing statutory framework.
- (b) *Pricing information*: Transpower's pricing is largely set by the TPM. In that context, it is difficult to understand the Commission's view that further disclosure is needed to "increase transparency around how Transpower allocates its revenue requirement".¹² The appropriate avenue for dealing with concerns around the allocation of revenue is through the TPM. Provided that Transpower complies with the TPM, in our view it is unnecessary for ID regulation to consider revenue allocation. To the extent that total revenue is to be disclosed (i.e., to assess whether s 52A(1)(d) is being satisfied), this should consider the context that total revenue (and therefore compliance with s 52A(1)(d)) is already controlled under the IPP.
- (c) *Major capex*: All major capex is specifically approved by the Commission and so there can be additional incentive properties created by ID regulation. Transpower does not have the freedom to make capex decisions unilaterally without regulatory approval. Even to the extent that broader transparency could incentivise particular investment outcomes, the capex input methodology already provides for consultation and disclosure.
- (d) *Asset-specific information and customer-specific information*: Part 4 is concerned with overall market outcomes and service supply, and the achievement of these *outcomes* are the matters that interested persons need to be able to assess. In our view, the performance of individual assets, or the circumstances of individual customers, are not relevant to interested persons' assessment of whether the purpose of Part 4 is being met. Requiring Transpower to provide such information

¹² Draft Reasons Paper, para [4.56].

will not (even partially) contribute to “sufficient” information being made readily available for this assessment. By requiring this level of disclosure the Commission has, in our view, departed from the workably competitive market outcomes at which Part 4 regulation is aimed.

Consistency with previous decision not necessary

- 18 The statutory framework promotes sector-specific consideration in its application of ID regulation, and empowers the Commission to adopt a tailored approach to determining specific ID requirements where necessary.
- 19 These aspects of the statutory framework that have led us to this view include:
- (a) Section 52P requires a separate ID determination for each regulated sector, rather than a uniform set of requirements that apply across all regulated sectors.
 - (b) Section 53C confers an appropriate level of flexibility to allow the Commission to tailor an ID determination in the manner it considers appropriate in the particular context (provided that the Commission maintains consistency with its other statutory requirements and natural justice considerations).
 - (c) Sections 52A and 53A include a number of statutory terms (such as “sufficient”) that are inherently flexible in their application (even if given a fixed construction).
- 20 The Commission is entitled (in our view perhaps even required) to make a contextual judgement of the relevant facts in applying the law. It is not bound to determine the same requirements as if they would have the same effect (in terms of Part 4 outcomes) in each case. Against that background it is unclear to us why the Commission relies on consistency with previous ID determinations that apply in unrelated sectors as a justification for setting ID requirements for Transpower.¹³ In our view, consistency with previous ID determinations is not itself adequate justification for particular Commission decisions.¹⁴

The Commission must justify the specificity of particular disclosures

- 21 Section 52P confers significant discretion on the Commission in making an information disclosure determination. Balanced against this wide discretion is the s 53A purpose statement, which places a strong obligation on the Commission to justify particular disclosure requirements. This burden becomes more acute the greater the level of detail (or generally more intrusive or costly) the requirement becomes. The Commission is required to demonstrate a specific need for the information. As a matter of public law, it is not sufficient for the Commission to rest its justification on a broad but unarticulated desirability of having the information made available generally.

¹³ Draft Reasons Paper, para [2.24].

¹⁴ Compare Draft Reasons Paper, para [2.24], [4.63].

- 22 The Commission appears to consider that detailed information is required to satisfy the statutory interests of interested persons wherever the Commission establishes the general relevance to Part 4 of a category of information. In our view, this reasoning is not sufficient. The particular level of detail set by the Commission requires its own justification, for the simple reason that a high-level disclosure may itself be “sufficient” for the purposes of the Act.
- 23 For example, paragraph C22 of the Draft Reasons Paper reveals an assumption that “interested persons will need to consider a number of more detailed sub-questions”. This is not necessarily true, particularly when considered in the context that:
- (a) interested persons will already have access to substantial amounts of information – much of it detailed – through other regulatory processes; and
 - (b) interested persons will have some comfort that other regulatory measures will have influenced Transpower’s conduct in a way that is consistent with the purpose of Part 4.
- 24 At some points the Commission justifies particular disclosures on the grounds they are necessary for accurate calculation of certain figures.¹⁵ In our view, this represents a misinterpretation of the purpose of ID regulation by the Commission. Ensuring accurate calculation is best treated as either an internal matter for Transpower or part of Transpower compliance requirements. It is the availability of information, not the availability of evidence of the veracity of that information, that serves to satisfy the purposes of Part 4.

The nature and purpose of information disclosure regulation

- 25 The scheme of Part 4 requires that the justification of particular ID requirements must relate back to the nature and purpose of ID regulation. The means by which ID regulation achieves its purpose is through a simple evaluative function. It allows for a class of persons (“interested persons”) to assess whether particular identified outcomes (as specified in s 52A) are being promoted. This transparency then incentivises the regulated supplier to act consistently with the purpose of Part 4 (to the extent that this conduct is not already required, for example under an IPP).
- 26 The purpose of ID regulation must be read and interpreted within this wider context of statutory text.¹⁶ The means by which ID regulation is intended to operate, as revealed in the wider statutory framework, therefore places important limits on the Commission’s otherwise broad discretion. In particular, a proper understanding of the statutory framework leads us to the view that ID regulation under Part 4 is *not* intended to:
- (a) Assist the Commission with its summary and analysis function.¹⁷ Summary and analysis applies in respect of disclosed information, but is not a valid reason to require the disclosure of information. The statutory framework carefully separates

¹⁵ Draft Reasons Paper, para [4.46].

¹⁶ Interpretation Act 1999, s 5(1).

¹⁷ Compare Draft Reasons Paper, para [5.20]-[5.23].

the disclosure function of ID regulation from the Commission's summary and analysis function by placing them in separate sections of the Act.

- (b) Allow for the Commission to monitor compliance with particular regulatory requirements (such as the IPP).¹⁸ The Commission and other regulatory agencies, such as the EA, have express powers under the Act to ensure that Transpower acts consistently with regulatory requirements.¹⁹ It would be a strained interpretation of the Act if ID regulation was intended to replicate powers and functions that are already provided for.
- (c) Provide a detailed assessment of performance outcomes (as opposed to outcomes specified in s 52A).²⁰ This is a secondary function only, which is effected through the Commission's summary and analysis function. ID regulation is not about company performance or business operations, but how services are supplied and how markets function. The primary function of ID regulation is therefore to allow for an assessment of whether the s 52A outcomes are being promoted.

27 This final point is especially important in our view, as it goes directly to the heart of the Commission's stated approach to developing ID regulation for Transpower. The Commission asserts (without justification) that in addressing the key matters identified in the Part 4 purpose statement (for example, is Transpower earning excess profits?), it is necessary for interested persons to address more specific sub-questions (for example, what are the drivers of profitability?).²¹ The nature and purpose of ID regulation means that it is only targeted at addressing Part 4 outcomes directly. To the extent that a perceived need to address "sub-questions" informs the Commission's justification for particular disclosure requirements, we consider that those requirements are vulnerable to legal challenge on public law grounds.

The Commission is not an interested person

28 The nature and purpose of ID regulation also reveals that justifications for particular disclosure requirements cannot legitimately be based on a perceived need for information by the Commission. The Commission has included itself in the list of persons that it considers to be an interested person.²² However, the Commission's role under subpart 4 is as an economic regulator, which is distinct from that of an interested person. In particular:

- (a) The express statutory requirements in s 53B(1) on regulated suppliers to provide to the Commission directly copies of all information disclosed publicly and supply to the Commission on request additional information over and above that information which is publicly disclosed are each consistent with the Commission having distinct functions and powers to that of an interested person.

18 Compare Draft Reasons Paper, para [5.12]-[5.17].

19 These compliance mechanisms are provided for in the measures themselves. For example, the IPP requires that Transpower provide to the Commission an annual compliance monitoring report.

20 Compare Draft Reasons Paper, para [C31].

21 Draft Reasons Paper, para [C22].

22 Draft Reasons Paper, para [C5].

- (b) Information to be provided to the Commission under s 53B(1)(b) is to be provided on a different timeframe to the information provided to interested persons. Specifically, a copy of the information disclosed under a s 52P determination must be provided to the Commission within five working days of making the information publicly available (that is, after making it available to interested persons). This temporal distinction between the Commission and interested persons applies notwithstanding that it is the same information.
- (c) The inclusion in s 53B(2) of express Commission functions regarding monitoring, summary and analysis of disclosed information suggest a role for the Commission that is inconsistent with merely assessing whether the purpose of Part 4 is being met. These functions are better understood as being undertaken for the benefit of interested persons who wish to assess whether the purpose of Part 4 is being met, rather than being undertaken by an interested person.
- (d) The term “interested persons” is not used elsewhere in subpart 4, and its relevance is confined to the purpose statement itself. Further, interested persons do not have any functions or powers expressly conferred on them by Part 4 (in contrast to the Commission), and the Commission is not described in the Act as acting as an interested person in respect of any of its express functions and powers.
- (e) The term “interested persons” is used throughout Part 4 of the Act to refer to persons other than the Commission who are interested in a matter.²³ In line with orthodox principles of statutory construction, a consistent interpretation should be given.

29 These points collectively provide a strong indication that the statutory intention is that the Commission is not an interested person for the purposes of subpart 4 of Part 4. Accordingly, the Commission’s need for information cannot form part of a justification for particular ID requirements.²⁴

30 There is a further public law consideration in addition to the clear statutory indications above that supports the view that it would be inappropriate to treat the Commission as an interest person. Administrative law standards generally require that a decision maker must not be interested in the outcome of its decision making, in order to protect against bias and predetermination. If the Commission were an interested person, then it would necessarily be interested in its own decision making. This risks the perception that the Commission is requiring the disclosure of information that serves its other functions under the Act, rather than seeking to achieve the purpose of ID regulation in a principled and reasonable fashion. The propriety of the Commission’s decision making would be undermined if it were to treat itself as an interested person.

23 See Commerce Act 1986, ss 52J(3)(b) and (d), 52V(2)(b) and (d), and 53T(1)(b). However, given the different context in which the term is used in subpart 4, we consider this factor is indicative rather than determinative.

24 Compare, for example, Draft Reasons Paper, para [2.22].

Minor points

- 31 There is some confusion as to whether supporting information is required to be retained for 7 years. The Draft Reasons Paper suggests that supporting information will need to be retained, but the Draft ID Determination only refers to the retention of disclosure information. The Commission does have power to require supporting information to be retained,²⁵ but in our view this is likely to be a costly exercise with little if any benefit when measured against the wider purpose of Part 4.
- 32 For clarity, we also note that the Commission has referred to “biannual” when biennial is intended in both the Draft Reasons Paper and the Draft ID Determination.²⁶ This should be amended.

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²⁵ Commerce Act 1986, s 53C(3)(c).

²⁶ See Draft Reasons Paper at para [3.4].