

Memorandum of advice

To Jeremy Cain, Transpower

From Mark Toner, Partner

Date 14 August 2013

Subject Settlement and Prudential Security Review: clearing manager's proposed power to require disconnection

Background

- 1 Webb Henderson has been asked by Transpower New Zealand Limited (**Transpower**) to comment, from an administrative and public law perspective, on the Electricity Authority's (**Authority**) proposal that the clearing manager be empowered to direct Transpower (or a distributor) to use its contractual powers to disconnect a defaulting direct purchaser (**disconnection proposal**).
- 2 We understand that Transpower seeks this advice as part of preparing its submission to the Authority in relation to the Settlement and Prudential Security Review of Part 14 of the Electricity Participation Code 2010 (**Code**).

Summary of advice

- 3 The disconnection proposal contemplates the creation of a regulatory discretion that is significant and highly unusual. This means that the disconnection proposal is itself a substantive issue that must be specifically addressed by the Authority in accordance with public and administrative law principles. To treat the disconnection proposal as ancillary or incidental to the wider Settlement and Prudential Security Review would leave the disconnection proposal vulnerable to legal challenge.
- 4 In particular, it is not clear that the Authority has identified and considered alternatives to the policy issue in question. We have identified four alternatives open to the Authority:
 - (a) introducing a bespoke agreement whereby direct purchasers agree that the clearing manager can order disconnection on default in return for a lower prudential security level;
 - (b) amending the Code so that direct purchaser default amounts to a breach of the Code;
 - (c) vesting the power to make disconnection decisions in the Rulings Panel, who is empowered to resolve complaints under the Code; or
 - (d) making use of High Court's jurisdiction to grant injunctive relief.

- 5 In addition, the administrative law burden on the Authority to justify the disconnection proposal would appear high. We consider that the substance of any defensible decision concerning disconnection powers would (at a minimum):
- (a) ensure that the decision-maker under the disconnection proposal is disinterested (that is, has no commercial interest in the decision);
 - (b) ensure that the decision process concerning disconnection is fair given the range of affected interests;
 - (c) target the parties involved directly rather than an intermediary; and
 - (d) form part of a broader disconnection policy that guides the decision-making process.

Disconnection proposal significant and unusual

- 6 The disconnection proposal contemplates the creation of a regulatory discretion that is:
- (a) significant because it interferes with contractual relationships with serious consequences for disconnecting a direct purchaser; and
 - (b) highly unusual because it devolves broad discretion affecting a range of competing interests to a “private” decision-maker.
- 7 The disconnection proposal is significant because of the potentially serious economic and safety consequences of disconnecting a significant user of electricity. A decision to withhold an essential input such as electricity will effectively shut down the direct purchaser’s operations. Disconnection matters are typically the subject of carefully-crafted contractual arrangements negotiated by sophisticated entities acting at arm’s length. The law does not take intervention in these matters lightly.
- 8 The disconnection proposal is also highly unusual from an administrative law perspective. It is very unusual for powers of this nature to reside in tertiary legislation and be devolved to, and exercised by, a private entity with virtually no statutory presence in the Electricity Industry Act 2010 (**Act**). As a result, the disconnection proposal involves an unusual mix of public and private law. It confers a regulatory (public) power on the clearing manager (a private party) to interfere with a (private) contract to which it is not party.
- 9 As far as we are aware it is unprecedented for a “private” party to have the power to exercise a regulatory discretion of this nature.
- 10 It is also relevant that, given what is at stake for a direct purchaser if its electricity supply is to be disconnected, the direct purchaser (or its creditors) may well seek an injunction to prevent Transpower from complying with any disconnection order, or to order reconnection. The most efficient solution may simply be to have the Court address the matter in the first instance.
- 11 The disconnection proposal also has significant consequences for Transpower. Transpower’s primary interest in maintaining the integrity of its network will often require it to remain neutral when disputes arise concerning non-payment between third parties. This primary interest may mean that Transpower, acting prudently, will need to manage any disconnection process to ensure potential for economic or physical harm is minimised.

Under the Settlement and Prudential Security Review, Transpower has no direct role in the issue of default by a direct purchaser. The dispute (and the relationship) exists between the direct purchaser and the clearing manager. Requiring Transpower (or a distributor in the same situation) to disconnect a direct purchaser in such circumstances, where its lack of direct involvement may mean it does not have full information, compromises Transpower's neutrality.

- 12 Transpower's role is analogous to an Internet service provider (ISP) in a dispute between a copyright owner and an end user. The role of an ISP has been given considerable recent attention, both in New Zealand and overseas, with broad acknowledgement that the ISP's role in such a dispute should be limited. In New Zealand, the ISP's role was substantially diminished between the original position under the proposed s 92A of the Copyright Act 2008 and the current law. Legislative proposals to have ISPs develop and implement their own policies to suspend the accounts of repeat copyright infringers were abandoned by Parliament, in part because of an ISP's mere conduit status.

Disconnection policy requires further explicit consideration

- 13 It is of concern that the disconnection proposal is being developed in the absence of a broader disconnection policy at the wholesale level. There are developed policies for disconnection in the retail context.¹ However, no such policies exist in the wholesale context, creating a vacuum for the decision-maker and the market. Guidance provided by such a policy would promote more consistent, transparent and disciplined decisions. Our concern is that the absence of a wider policy may result in inconsistent, unsupported or arbitrary decisions, which risk undermining efficiency and confidence in the market as well as being open to legal challenge.
- 14 We have particular reservations about the substantive treatment of the disconnection proposal in the Settlement and Prudential Security Review consultation paper. It does not appear that the disconnection proposal has been subject to the same standard of analysis and opportunity for informed consultation as other material proposed Code amendments. Rather, the consultation paper appears to treat the disconnection proposal as merely ancillary, or even incidental, to other policy decisions that form part of the wider Settlement and Prudential Security Review.
- 15 In light of the significant and unusual nature of the disconnection proposal we would expect to see the Authority:
- (a) clearly articulate the policy issue that the disconnection proposal is intended to address;
 - (b) identify the range of possible solutions to that policy issue that stand as credible alternatives to the disconnection proposal;
 - (c) consult openly, fairly and reasonably on the advantages and disadvantages of each alternative; and

1 See the Authority's guidelines on arrangements to assist medically dependent and vulnerable consumers.

- (d) demonstrate that the disconnection proposal (or any relevant alternative) is consistent with the Authority's statutory objectives.²
- 16 On the face of the consultation paper the Authority does not appear to have taken these steps in respect of the disconnection proposal.
- 17 Even if the steps in paragraph 15 are followed, the unusualness and seriousness of any power of disconnection means that the administrative law burden on the Authority of justifying any decision is particularly high. In order to satisfy that burden, we consider that the Authority would be required to (at a minimum):
- (a) ensure that the decision-maker under the disconnection proposal is disinterested;
 - (b) ensure that the decision process concerning disconnection is fair given the range of affected interests;
 - (c) target the parties involved directly rather than an intermediary; and
 - (d) formulate a broader disconnection policy that guides the decision-making process.
- 18 We consider that the need to identify possible alternatives is particularly acute in this context. Given that the Authority is proposing the creation of a novel and untested discretionary power, the disconnection proposal is likely to be difficult to justify if the wider legislative scheme provides established, workable alternatives.
- 19 It is not clear that the Authority has identified and considered alternatives to the policy issue in question. We have identified four alternatives potentially open to the Authority:
- (a) introducing a bespoke agreement whereby direct purchasers agree that the clearing manager can order disconnection on default in return for a lower prudential security level;³
 - (b) amending the Code so that direct purchaser default amounts to a breach of the Code;
 - (c) vesting the power to make disconnection decisions in the Rulings Panel, who is empowered to resolve complaints under the Code;⁴ or
 - (d) making use of High Court's jurisdiction to grant injunctive relief.
- 20 In respect of this final alternative, we observe that the Authority has the power, at any time, to seek an injunction from the High Court to prevent a direct purchaser from doing anything that is in breach of the Code, or requiring the direct purchaser to do something in accordance with the Code.⁵
- 21 Some of the potential advantages in these alternative mechanism include that they would:
- (a) address the risk directly;

2 See Electricity Industry Act 2010, s 32(1).

3 Wholesale Advisory Group *Settlement and Prudential Security Review – Discussion Paper*, page 15.

4 Electricity Industry Act 2010, s 50.

5 Electricity Industry Act 2010, s 51.

- (b) have the decision made by independent experts, well-versed in balancing the interests of competing parties, relying on well-settled principles;
- (c) leverage off existing remedies; and
- (d) carry an added sanction of a breach of the Code.

Impartial and robust decision-making process required

- 22 The disconnection proposal involves a range of competing interests, including those of the direct purchaser, the generator, the clearing manager and Transpower (or a distributor). Each of these competing interests needs to be understood and weighed carefully because of the severe impact a decision to disconnect may have. In such circumstances public law principles require a fair and reasonable decision-making process.
- 23 However, the disconnection proposal does not include any process to ensure a full range of affected interests are taken into account as part of the decision to order disconnection. Nor is there any requirement for the clearing manager to develop any methodology to assist it in its decision-making process.⁶ Under the disconnection proposal, the clearing manager can simply decide to disconnect as if it is (indirectly) exercising a contractual right, without the usual public law protections that would commonly apply:
- (a) there is no call for submissions to the clearing manager, for example, which would be prudent given the clearing manager has a discretion to exercise this power;
 - (b) there are no wider guidelines or policy statements providing market guidance on the exercise of the disconnection power, meaning limited certainty and transparency for the market (see below); and
 - (c) there is no credible appeal mechanism providing the necessary supervision where there are a number of affected interests and the need for a quick decision.⁷
- 24 The interim injunction process provides a useful analogy to both the process and the considerations that should be addressed before a decision is made to order the disconnection of electricity from a direct purchaser. In the court process, submissions and supporting affidavit evidence are filed. There is an oral hearing and the parties have the ability to respond to each other's arguments as well as any concerns or questions of the decision-maker. The decision is made by application of tried, tested and well-settled principles that involve considering how the parties would be affected by the grant or refusal to grant the injunction and whether any damage that might arise as a result of the decision could be redressed. In our view, a comparable level of procedural fairness ought to be incorporated into the process no matter who the decision-maker is.
- 25 Under the disconnection proposal, the power to order disconnection lies with the clearing manager. However, the clearing manager is not a disinterested decision-maker. The clearing


6 Electricity Authority *Settlement and Prudential Security Review – Consultation Paper*, para [4.5.1].

7 An appeal process provides some oversight. This would not have to involve a time-consuming procedure, and could be limited to a process for a rapid-fire internal appeal by any affected party (distributor, Transpower or direct purchaser) to the Authority, for example.

manager is liable to a generator for any financial loss it suffers as a result of the clearing manager's failure to comply with its obligations under the Code.⁸ The clearing manager will therefore necessarily have an interest in the outcome of its own decision making.

- 26 There is clearly a risk that this interest could incentivise the clearing manager to act with undue haste and without regard for competing interests. Even if the clearing manager's interest does not affect its decision in this way, the perception of a conflict of interest means any decision will be open to challenge on the grounds of bias.
- 27 The consequences of disconnection are sufficiently severe that the decision to order disconnection should be made by an independent body with the institutional capability to make robust and fair decisions. In the current context, the Electricity Authority may itself be the best-placed decision maker, as the requirement that it comply with its statutory objectives would help ensure it exercises its discretion in a disinterested fashion.
- 28 In our view, serious consideration ought to be given to leaving any decision to disconnect to the Courts. In the context of disconnection from the Internet for alleged breach of copyright, where the effects of the decision are arguably much less severe, the disconnection decision may only be made by the District Court. This suspension order power was originally proposed to sit with the Copyright Tribunal, an independent tribunal within the Ministry of Justice. However, Parliament saw fit to amend the Bill to move that power to the District Court, recognising the Court's experience in weighing competing considerations as an impartial decision-maker. The Explanatory Note to the Copyright (Infringing File Sharing) Amendment Bill expressly notes: "[a] court is better equipped to consider whether suspension is appropriate in the circumstances of each case. The Bill gives examples of things the court must consider, including the seriousness of the infringing".⁹

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⁸ See Electricity Industry (Enforcement) Regulations 2010, reg 65.

⁹ Explanatory Note to the Copyright (Infringing File Sharing) Amendment Bill, page 3.