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Attention: Ralph Matthes

IS THE COMMERCE COMMISSION OBLIGED TO AMEND OR REVIEW THE COST OF CAPITAL INPUT METHODOLOGY?

Summary

1. You have asked whether the law which authorises the Commission to make, amend and review input methodologies, and obliges the Commission to review input methodologies at least once every seven years, may impose an obligation or duty on the Commission to carry out such a review in the circumstances outlined in the Commission's invitation of 20 February 2014.

2. In our opinion the case law under which the Courts have ordered that a statutory discretion be exercised, could well extend to these circumstances. Each case turns on the particular statutory purposes and circumstances. We think they combine in this case to make it more likely than not that a court would hold the Commission to be under a compelling duty to use the prescribed processes of consultation with a view to amendment.

3. That conclusion is on balance. It does not mean that the Commission is obliged to proceed through to complete an amendment or that a review will result in any particular change, because the information that emerges during consultation may be persuasive against a change. But in our opinion there are strong arguments that the Commission is duty bound to issue a notice of intention to amend (or review) the cost of capital IMs forthwith.

The law

4. The Commerce Act does not expressly empower the Commission to amend input methodologies. Instead s 52X says "if the Commission proposes to amend an input methodology by making a material change, section 52V [which governs consultation in determining methodologies] applies as if the amendment were a new input methodology".

5. In other words the power to amend is treated as inherent in the scheme for methodologies, and the only constraint is a requirement for consultation. Though market participants may commonly treat them as if they were designed and expected to run for 7 years, in fact the Commission is obliged to review them no later than 7 years after the date of publication. There is nothing in the statute that would prevent the Commission reviewing them as frequently as it chooses to achieve its objectives and the statutory purposes. The only

constraints would be real-world ones, such as resourcing limitations. There are number of provisions in Part 4 which assist the Commission to plan its work and to husband its resources.

6. In full s 52X reads:

> ***Amendment of input methodologies***
>
> *If the Commission proposes to amend an input methodology by making a material change, section 52V applies as if the amendment were a new input methodology.*

7. On a plain reading, the relevant provisions do not express any duty or obligation on the Commission to exercise the review or amendment powers in any particular circumstances.. However, a body of precedent empowers the Courts to enforce the application of statutory functions or powers in a manner consistent with the purpose of the empowering Act. In effect the court may treat a power or function as creating a corresponding duty to act. The cases which explore that situation have commonly involved applications for an order of *mandamus*.

8. In *Julius v Lord Bishop of Oxford & Anor*[1], a seminal case on the issue, the Lord Chancellor postulated:

> *[T]hat where a power is deposited with a Public Officer for the purpose of being used for the benefit of persons who are specifically pointed out, and with regard to whom a definition is supplied by the Legislature of the conditions upon which they are entitled to call for its exercise, that power ought to be exercised, and the Court will require it to be exercised."*

9. The modern application of mandamus is explained in *Right to Life New Zealand Incorporated v Rothwell* by Wild J (emphasis ours)[2]:

> *a) Mandamus is available to enforce the performance of a statutory duty resting on the body being reviewed, which duty is clearly ascertainable from the relevant statute.*
>
> *b) Generally, the Court is only able to order that the duty be carried out "according to law", not that it be performed in a particular way.*
>
> *c) Although mandamus will not lie to compel the exercise of a discretion in a particular way, it is available to compel or direct the body under review to exercise a statutory discretion which it has refused or failed to exercise, or is exercising **in a manner that frustrates the objects of the***

[1] [1880] UKHL 1 (23 March 1880)

[2] *Right To Life New Zealand Inc v Rothwell* [2006] 1 NZLR 531 (HC) Wild J para [6]

statute *conferring the discretion: Padfield & Ors v Minister of Agriculture, Fisheries and Food & Ors [1968] AC 997 (HL), in particular Lord Reid at 1030.*

10. The issue in *Padfield* is not dissimilar to the present matter. It involved a power of the relevant Minister to direct an investigation into milk pricing. The Minister declined to exercise this power, believing he had an unfettered jurisdiction. The House of Lords decided that Parliament "must have conferred the discretion with the intention that it should be used to promote the policy and objects of the Act."

11. The unifying thread through both the United Kingdom and New Zealand authorities on *Mandamus* is the requirement that the duty be consistent and ascertainable from the purpose of the relevant Act.

12. With respect to regulated goods or services, we think a court would reach a similar conclusion drawing on the specific purposes in section 52A of the Act:

> *(1) The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services—*
>
> *(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and*
>
> *(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and*
>
> *(c) share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and*
>
> *(d) are limited in their ability to extract excessive profits."*

13. The High Court decision sent the Commission strong signals that there may be no rational underpinning of the choice of the 75th percentile of the WACC range (the uplift). That leaves uncertainty that almost certainly negates the investment promotion or incentive purposes of the uplift. In the absence of such a justification, suppliers and consumers are left with a clear and acknowledged expectation of persistent excessive profits.

14. The statutory words which create the duty for the Commission are not absolute. It is obliged only to "promote" the long term benefit of consumers, and to "promote outcomes" consistent with competitive market outcomes, and to "limit" the ability to extract excessive profits.

15. But the drafters' realism in language that recognises the limitations of regulatory power does not detract from the prescriptive force of the mission conferred on the Commission by the statutory purpose. In our opinion a court would not accept a situation in which the Commission fails to do all that is reasonably practical to remedy a misdirected methodology after it is effectively 'on notice' of provisions that run counter to a purpose of the Act after their logical support has been negated.

16. A Court would give full weight to practical impediments to an amendment or review, including time and resource limitations. But it would expect more than an assertion that they were prohibitive. It would expect to weigh the competing priorities for those resources against any evidence supplied of the effects of the continuing uncertainty or contradictions on the achievement of the statutory purposes.

17. We have considered some of the New Zealand decisions where the Court has declined relief for *mandamus*. Some of the obvious barriers are clearly not applicable in this case, including that:

    a. The order sought was not practically or legally enforceable;[3]

    b. The duty was "permissive rather than mandatory";[4] or

    c. If another legal remedy is "equally beneficial, convenient and effective."[5]

18. In our opinion it is more likely than not that as presently informed the Commission may be obliged to commence amendment or review processes.

Yours faithfully
FRANKS & OGILVIE

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[3] *Challis v Destination Marlborough Trust Board Inc* CA37/03, 8 December 2003
[4] *Bleakley v Environmental Risk Management Authority* HC Wellington CIV-2004-485-1042
[5] *Barton v Licensing Control Commission* [1982] 1 NZLR 31 (HC)