IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV 2018-404-2214
[2019] NZHC 540

UNDER	Parts 4 and 6 of the Commerce Act 1986
BETWEEN	COMMERCE COMMISSION Plaintiff
AND	VECTOR LIMITED Defendant

Date:	6 March 2019
Counsel:	J Every-Palmer QC, L A O'Gorman and R Cahn for Plaintiff J A Farmer QC, SDJ Peart & M Singh for Defendants
Judgment:	22 March 2019

JUDGMENT OF DUFFY J

This judgment was delivered by me on 22 March 2019 at 11 am pursuant to Rule 11.5 of the High Court Rules.

Registrar/ Deputy Registrar

Buddle Findlay, Auckland
J D Every-Palmer QC, Barrister, Wellington
Chapman Tripp, Wellington
J A Farmer QC, Barrister, Auckland

[1] In this proceeding, the Commerce Commission (the Commission) claims that Vector Limited (Vector), which carries on business as an electricity and gas distribution company in Auckland, has failed to achieve the Quality Standards prescribed under the Commerce Act 1986 (the Act) for the 2015 and 2016 Assessment Periods. Vector admits the contraventions. The parties have agreed on a penalty. The suitability of that penalty is the subject of this hearing.

[2] I consider the agreed penalty appropriate.

Legal framework

[3] Part 4 of the Commerce Act 1986 governs regulation of industries where there is little or no competition and no likelihood of a substantial increase in competition.[1] The purpose of that part is to create outcomes akin to those in competitive markets. These purposes are to be achieved by ensuring that suppliers of regulated goods or services: [2]

(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.

[4] One of the ways consumers are protected against the lack of competition is through the imposition of price-quality regulations. Electricity line services are subject to price-quality regulation set out in determinations of the Commission under s 52P of the Commerce Act. There are three determinations relevant to this hearing, which are referred to collectively as the "Default Price-Quality Path Determinations"

1 Section 52.
2 Section 52A.

(DPPs). Those paths specify either or both of the maximum prices and revenues that may be charged and recovered, and the Quality Standards that must be met.[3] The Quality Standards are important, as by limiting the maximum prices charged and revenues recovered, distributors may attempt to gain short term benefits through reducing expenditure and "running down the network".

[5] The relevant DPPs are:

(a) the Electricity Distribution Services Default Price-Quality Path Determination 2010 dated 30 November 2009 (DPP 2010) which applied from 1 April 2010 to 31 March 2013;

(b) the Electricity Distribution Services Default Price-Quality Path Determination 2012 dated 30 November 2002 (DPP 2012) which applied from 1 April 2013 to 31 March 2015; and

(c) the Electricity Distribution Services Default Price-Quality Path Determination 2015 dated 28 November 2014 (DPP 2015) which applied from 1 April 2015 to 31 March 2020.

[6] Distributors participate in setting DPPs and the related input methodologies.[4] Methods for making determinations are subject to appeals on the merits,[5] appeals on points of law,[6] and regular challenge by judicial review. Further, a s 52P determination itself in respect of a DPP is subject to appeal on questions of law.[7] If a distributor considers a DPP is not appropriate for its circumstances, it can apply for a customised price-quality path.[8]

[7] To comply with a Quality Standard, a distributor must either comply with the annual reliability assessment specified or have complied with those annual reliability

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3 Section 53M.
4 Section 52V.
5 Section 52Z.
6 Section 91 (1B).
7 Sections 91 (1)(a)(ii) and 91 (1B).
8 Section 53P (2).

assessments for the two immediately preceding extant Assessment Periods. The annual reliability assessments provide that:

(a) A non-exempt EDB's SAIDI assessed value for a given Assessment Period must not exceed the maximum specified in the relevant DPP; and

(b) A non-exempt EDB's SAIFI assessed value for a given Assessment Period must not exceed the maximum specified in the relevant DPP.

[8] Vector is a non-exempt EDB. An Assessment Period is defined as:

(a) In DPP 2010 and DPP 2012, a period of 12 months ending on an "Assessment Date", where Assessment Date means a date as at which compliance with the default price-quality path must be demonstrated, being 31 March of each year of the years 2011 to 2015; and

(b) In DPP 2015 as a 12 month period commencing on 1 April and ending on 31 March of the following year for which compliance with price-quality requirements is assessed.

[9] SAIDI represents the average period of outages experienced by each customer on the network during successive 12 month periods ending 31 March. The SAIDI value is calculated by aggregating the duration of all services interruptions across all customers during the relevant periods, and then dividing by the number of customers. External factors and random variability are accounted for in the SAIDI value by setting the maximum acceptable value one standard deviation above the historical average, and limiting the effect of one-off events such as severe storms. The effect of these events is limited by designating these days as "major event days" and applying an upper limit for the maximum number of SAIDI minutes deemed to arise for each day. Further, for a quality standard to be contravened, the reliability assessment must be exceeded in the particular, and also in one or both of the previous assessment periods.

[10] The existence of the SAIDI measure recognises the harm suffered by customers from outages. The typical impact varies by category of customer, but includes:

(a) interruption to industrial processes, and consequential losses including staff downtime, wasted product and the costs of cleaning and disposal required to recalibrate the supply chain; and

(b) forced closure or interruption of services, and accompanying loss of revenue, loss of perishable items and wasted staff costs; and

(c) loss of heating and hot water, loss of revenue for people working from home.

[11] Section 87 (1)(a) of the Act allows the court, on application of the Commission, to order a person to pay a pecuniary penalty to the Crown when the court is satisfied that the person has contravened any price-quality requirement applying to the regulated goods or services.

[12] In setting the amount of pecuniary penalty, the court must take into account the following matters:

(a) the nature and extent of the contravention:

(b) the nature and extent of any loss or damage suffered by any person as a result of the contravention:

(c) the circumstances in which the contravention took place (including whether the contravention was intentional, inadvertent, or caused by negligence):

(d) whether or not the person has previously been found by the court in proceedings under this Part to have engaged in similar conduct

[13] The maximum penalty must not exceed $500,000 in respect of each act or omission in the case of an individual, of $5,000,000 per act or omission in any other case.

Agreed facts

[14] The application proceeds on the basis of an agreed statement of facts. The agreed facts are as follows.

[15] Vector's annual reliability performance for the 2012 to 2016 assessment was:

Assessment Period	SAIDI Limit	Assessed SAIDI	Assessed SAIFI	Annual reliability assessment	Quality Standard
2012	127	96	1.86	Within	Compliant
2013	127	96	1.86	Within	Compliant
2014	127	141	1.86	Exceeded	Compliant
2015	127	178	1.86	Exceeded	Contravened
2016	104	117	1.40	Exceeded	Contravened

[16] Vector has agreed it has breached the SAIDI Quality Standard for the assessment periods 2015 and 2016.

[17] The parties have not been able to agree upon the quantification of the loss to customers of Vector. However, they have agreed that the extent of loss caused by contraventions is at least equivalent to the penalty they propose and that such loss warrants the proposed penalty.

[18] The parties agree that there has been a material deterioration in Vector's service quality in the 2014 to 2016 assessment period. They accept that Vector's conduct was a key driver of its contraventions, and that aspects of Vector's practices were not in accordance with good industry practice. Vector accepts that the degrees to which it has fallen short of good industry practice warrant the recommended penalty.

[19] Factors the parties have agreed affected the SAIDI standards are:

(a) Governance of compliance with the quality standards.

(i) Vector's governance of compliance with the Quality Standards failed to meet good industry practice by not being sufficiently critical of its own performance in managing SAIDI, instead justifying increased SAIDI as being out of its control;

(ii) Vector underestimated the growing risk of non-compliance in not giving sufficient priority within its corporate risk registers and proposing inadequate controls for management of risk during and after contraventions;

(iii) Vector failed to have methods to predict and plan for the effects of foreseeable increased traffic congestion overtime, such as in traffic "hot spots". Specifically, it failed to act in accordance with good industry practice by not relocating parts of depots, allocating work crews in a manner that enables faster response times, and in other resourcing improvements.

(b) Asset life cycle management practices

(i) Vector's life cycle asset management processes and framework were generally of an appropriate standard. However, certain aspects failed to meet good industry practice.

(ii) Fault cause data suggests that the condition or health of certain overhead asset types and underground assets have deteriorated since the beginning of DPP 2012, corresponding with a growing list of assets that are nearing the end of their life, but only few being addressed during that specified timeframe;

(iii) Vector did not have a sufficiently holistic and agile asset management approach. Such an approach was necessary for it to appropriately respond to the increasing risk of non-compliance through DPP 2012 and into DPP 2015. For example, Vector did not have a proactive replacement program at the time for small sized conductors, and Vector's asset management plans did not at that stage identify any response or root cause of the increase in underground outages, with the exception of a Penrose incident. The absence of such an approach inhibited Vector's ability to predict the effects of trends on reliability and compliance, and to implement active strategies to manage these effects;

(iv) Vector did not routinely carry out post-implementation reviews of important projects and programs following their roll out, thus failing to develop learnings that can be applied to future projects and programs.

(c) Data systems and reliability reporting

(i) Vector's data systems and reliability reporting broadly met good industry practice. Vector has good systems to monitor and report on reliability, and undertakes the analysis and report production necessary to advise the business on the factors driving unreliability. However, aspects of Vector's approach to managing reliability did not meet good industry practice.

(ii) Specifically, Vector did not have a consolidated and documented strategic reliability management plan, which would have helped identify key issues and solution options, provided some framework for assessing solutions and helped to communicate important matters throughout the business;

(iii) Further, after exceeding SAIDI in the 2014 assessment period, Vector failed to consider available options to address the risk of future non-compliance, with the exception of the "40-worst feeder program".

(d) Vegetation management

(i) Vector's practices for vegetation management failed to meet good industry practice.

(ii) Vector should have been aware of the risk of non-compliance due to the increasing number of vegetation-related outages. It failed to put in place sufficiently proactive plans and methods to address those issues in the course of DPP 2012 and DPP 2015;

(iii) Vector should have placed greater focus on managing 'out of zone vegetation' that posed potential reliability hazards by seeking arrangements with relevant tree owners;

(iv) Vector did not redirect expenditure to managing vegetation when this would have been appropriate risk management, and/or more efficient than dealing with the consequences or worsening vegetation trends in the form of increases in SAIDI minutes;

(v) Vector's arrangements with its vegetation service provider lacked sufficient strategic direction, oversight and control. Further, those arrangements were insufficiently audited and did not sufficiently incentivise the provider to manage reliability and compliance.

(e) Arrangements with field service providers

(i) Vector's contractual arrangements with its field service providers (FSPs) generally met good industry practice. However, aspects of Vector's arrangements with FSPs failed to meet good industry practice as follows:

(ii) The FSP contracts did not include an incentive focused specifically on the average duration of a customer supply interruption over the measurement period, and did not include any penalty for non-performance (other than not achieving a bonus);

(iii) The roles and responsibilities for delivery of field services placed too much responsibility on the FSPs to identify and prioritise work, instead of Vector taking a greater role in the strategic direction of field services delivery.

(f) Management of Penrose outage

(i) The Electricity Authority commissioned a report into a major outage arising from a fire at the Penrose substation on or around 5 October 2014.[9] The report found that Vector failed to take appropriate steps before that fire which would have minimised the impact of that fire on consumer outages, including:

(ii) Failing to identify and manage the risks associated with co-location of multiple power cables in a single cable trench installation, especially given the criticality of the Penrose trench to electricity supplies over a wide area; and

(iii) Failing to take appropriate risk control and mitigation steps for a high impact low probability event. Specifically, Vector should have addressed the risk of fire ignition due to cable joint failures in in-air situations and the risk posed by co-location of multiple cables in an in-air trench.

(g) Health and Safety Practices

(i) During DDP 2012, Vector implemented changes to its health and safety practices. The most significant was to substantially limit the circumstances in which Vector and its FSPs undertook

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[9] Vector is legally challenging decisions made by Utilities Disputes Limited in favour of a small number of large commercial customers that relied in part on the Electricity Authority's findings in its Penrose report.

to work on energised lines. While the health and safety practices implemented by Vector were within the scope of good industry practice, they represented a relatively risk-averse approach with regard to managing safety risks. At best estimate, the extent to which Vector's changes to health and safety practices increased SAIDI were 6.3 minutes, 7.6 minutes and 9.4 minutes for 2014, 2015 and 2016 respectively.

(ii) Although Vector's health and safety practices were within the scope of good industry practice, Vector failed to act in accordance with good industry practice by omitting to take steps open to it to mitigate or prevent the effect on SAIDI of those changed health and safety practices, therefore ensuring those changes in practice did not materially affect its ability to comply with the quality standards.

(h) Wind

(i) The average wind speed was marginally higher in the 2014 assessment period than in a typical assessment period. However, it was not materially higher than several other years in which Vector had not exceeded its SAIDI limit. Wind events were therefore at a level that could reasonably have been expected to be accommodated by Vector in complying with the SAIDI limit.

(ii) There were a significantly higher number of extreme wind speed events in Vector's supply area in the 2015 assessment period. Even if Vector had met good industry practice in the 2015 assessment period, it would likely have exceeded its SAIDI limit due to this higher number of extreme wind events. However, Vector's failure to meet good industry practice in other areas exacerbated the extent of the contravention in the 2015 assessment period.

(i) Traffic

(i) Traffic in Vector's supply area during the relevant assessment periods was heavier than in prior assessment periods. The likely extent to which this increased SAIDI was 1.5 minutes, 2 minutes and 2.5 minutes in 2014, 2015 and 2016 respectively.

(ii) While traffic congestion in Auckland may have worsened, this was entirely foreseeable and is an issue faced by other distributors.

(iii) Vector failed to take appropriate steps to avoid increased SAIDI minutes due to worsened congestion.

The agreed penalty

[20] The parties have proposed a total penalty of $3,575,000. This reflects penalties of:

(a) $1,950,000 in respect of 2015, being a starting point of $3,000,000 with a discount of 35% for mitigating factors; and

(b) $1,625,000 in respect of 2016, being a starting point of $2,500,000 with a discount of 35% for mitigating factors.

[21] A negotiated resolution to a proceeding for a civil penalty under the Act is in the interests of both the public and the parties. Such a resolution avoids the costly, time consuming and uncertain nature of litigation. There is significant authority for the proposition that such a proposal is appropriate under parts 2 and 3 of the Commerce Act.[10] Whilst this proceeding is under part 4, there is no reason for a different approach to negotiated penalties. The parts serve similar objectives in that part 4 seeks

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[10] *Commerce Commission v Alstom Holdings SA* HC Auckland CIV-2007-2165, 22 December 2008; *Commerce Commission v New Zealand Diagnostic Group Ltd* HC Auckland CIV-2008-404-4321, 19 July 2010; *Commerce Commission v Geologistics International (Bermuda) Ltd* HC Auckland CIV-2010-404-4590, 22 December 2010; *Commerce Commission v Whirlpool SA* HC Auckland CIV-2011-404-6362, 19 December 2011; *Commerce Commission v Kuehne + Nagel International AG* [2014] NZHC 705.

to promote conduct akin to that of a competitive market, whereas parts 2 and 3 seek to promote competition.

[22] This is not to say that the parties may arrive at any figure they wish. It is ultimately the Court's responsibility to determine the penalty. Any figure proposed by the parties must be within a range which satisfies both the objectives of the Act and the particular circumstances of the case.[11]

Analysis

[23] The accepted approach in setting a pecuniary penalty for a contravention of Part 2 or 3 of the Act is "to establish an appropriate starting point having regard to the maximum penalty and then adjust this starting point to take account of any aggravating or mitigating factors specific to each defendant".[12] This hearing is of course under part 4. The parties submit that it is appropriate to adopt the same approach to setting penalties under Part 4 of the Act.

[24] In setting the amount of pecuniary penalty, the Court must take into account the following matters:

(a) the nature and extent of the contravention:

(b) the nature and extent of any loss or damage suffered by any person as a result of the contravention:

(c) the circumstances in which the contravention took place (including whether the contravention was intentional, inadvertent, or caused by negligence):

(d) whether or not the person has previously been found by the court in proceedings under this Part to have engaged in similar conduct

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11 *Commerce Commission v Geologistics International (Bermuda) Ltd* CIV 2010-404-5490, 22 December 2010 at [37]; *Commerce Commission v Alstom Holdings SA* [2009] NZCCLR 22 (HC) at [18]; *Commerce Commission v Enviro Waste Services Ltd* [2015] NZHC 2936.

12 *Commerce Commission v Property Brokers Ltd* [2017] NZHC 681, [2017] NZCCLR 14 at [4].

[25] The statutory maximum penalty for the contravention of a price-quality requirement is $5,000,000 in respect of each quality standard contravention.

[26] These were serious contraventions. The size of the contravening party is an important factor in determining the seriousness of the contraventions. This is because any penalty must take account of both the size and resources of the party,[13] and the effect on its customers. Vector is the largest electricity distribution business in New Zealand, having at least 540,000 or more customers at the relevant time. Those customers are likely to have suffered losses like those detailed at [10]. A significant penalty must be imposed to act as an effective deterrent to Vector and other distributors.

[27] A main purpose of quality standards is preventing distributors making excessive profit from “running down” a network and improperly reducing expenditure. Here, Vector made profits below the maximum permissible profit during the contravening years, which indicates that these were not cynical breaches designed to extract maximum profit from a non-competitive market.

[28] Further, as the parties have acknowledged, a portion of the SAIDI limit contravention came from Vector’s changed policy on health and safety. The most significant change was adjusting the policy on when they would work on live lines. I consider this reduces the severity of the contravention.

[29] Vector has not previously been found by the court in proceedings under part 4 to have engaged in similar conduct.

[30] As is customary in these types of proceedings, I propose to adopt an approach to penalty that aligns with the sentencing approach set out in *R v Taueki*.[14] I consider the starting points of $3,000,000 and $2,500,000 to be appropriate for the contraventions. Such starting points appropriately take account of the factors agreed to by the parties in their agreed statement of facts, and those mentioned above. There are no aggravating factors.

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13 *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 344 at [54].
14 *R v Taueki* [2005] 3 NZLR 372 (CA).

[31] In line with conventional sentencing principles, Vector is entitled to a significant mitigation discount on the proposed starting points. Vector has cooperated with the investigation. It voluntarily provided information, and provided the Commission with assistance in its inquiry. Vector admitted liability, and offered to settle the proceedings immediately upon receipt of the Commission's notification that it intended to pursue enforcement action. Vector has made payments under its service guarantee payment scheme. Further, Vector has made efforts to work towards future compliance. Accordingly, I consider the discount of 35% proposed by the parties to be within the appropriate range.[15]

[32] It follows that I am satisfied the suggested penalty is within the appropriate range.

Conclusion

[33] I make the following orders:

(a) Vector Limited to pay a pecuniary penalty of $3,575,000; and

(b) Payment to be made within 20 working days; and

(c) costs lie where they fall.

Duffy J

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15 The parties have referred me to *Commerce Commission v Enviro Waste Service Ltd* [2015] NZHC 2936; *Commerce Commission v Property Brokers Ltd* [2017] NZHC 681, [2017] NZCCLR 14; *Commerce Commission v Lodge Real Estate Ltd* [2017] NZHC 1875; *Commerce Commission v Lodge Real Estate Ltd* [2016] NZHC 3115; *Commerce Commission v Barfoot & Thompson Ltd* [2016] NZHC 3111; *Commerce Commission v Property Brokers Ltd* [2016] NZHC 2851; *Commerce Commission v Bayley Corp Ltd* [2016] NZHC 1493; *Commerce Commission v Unique Realty Ltd* [2016] NZHC 1064; *Commerce Commission v Rural Livestock Ltd* [2015] NZHC 3361.