IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

I TE KŌTI MATUA O AOTEAROA
TE WHANGANUI-A-TARA ROHE

CIV 2019-412-134
[2020] NZHC 610

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

Hearing: 16 March 2020

Counsel: L A O'Gorman, E J Watt and R Cahn for Plaintiff
T D Smith, S D Peart and S I A Harker for Defendant

Judgment: 23 March 2020

JUDGMENT OF MALLON J

Introduction

[1] The defendant, Aurora Energy Limited (Aurora), is an electricity distribution company. It provides electricity lines services in the Dunedin, Central Otago and Queenstown Lakes areas. The supply of its services is subject to regulation under Part 4 of the Commerce Act 1986 (the Act). This regulation includes quality standards that suppliers are required to meet. On the application of the Commerce Commission (the Commission), the Court can impose pecuniary penalties if the quality standards are contravened.

[2] The Commission claims that Aurora contravened the quality standards between 2016 and 2019. Aurora accepts this. The Commission and Aurora have agreed to recommend that the Court impose a total penalty of $4,997,200 for those contraventions.

[3] The established approach in such circumstances is for the Court to impose the penalty that has been agreed between the parties, as long as it falls within an appropriate range that satisfies the objects of the Act and the particular circumstances of the case.[1] This is because of the interests of the parties and the public in promoting a resolution and thereby avoiding costly, time-consuming and uncertain litigation.[2]

The quality standards

[4] Part 4 of the Act provides for the regulation of goods and services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition. Electricity lines services are in this category. Aurora is subject to information disclosure regulation and price-quality regulation as a supplier of these services.

[5] The purposes of the price-quality regulation include limiting the ability of suppliers to extract excessive profits and providing incentives to suppliers to provide services at a quality that reflects consumer demands. Quality standards are essential to the efficacy of Part 4.[3] Without them, electricity distribution businesses can earn excessive profits by underspending on their networks, defeating the purpose of the regulations.

[6] The price-quality regulations are set out in determinations made by the Commission under s 52P of the Act. In this case, the relevant determinations are referred to as the default price-quality path determinations (DPPs). The DPP principally contravened by Aurora over the period between 2016 and 2019 was the

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1 See for example: *Commerce Commission v Alstom Holdings SA* [2009] NZCCLR 22 (HC) at [18]; *Commerce Commission v Geologistics International (Bermuda) Ltd* HC Auckland CIV-2010-404-5490, 22 December 2010 at [37]-[39]; *Commerce Commission v Air New Zealand Ltd* [2013] NZHC 1414 at [27]; *Commerce Commission v New Zealand Diagnostic Group Ltd* HC Auckland CIV-2008-404-4321, 19 July 2010 at [45]; and *Commerce Commission v Vector Limited* [2019] NZHC 540 at [22].

2 See for example: *Commerce Commission v Alstom Holdings SA*, above n 1, at [18]; *Commerce Commission v Kuehne + Nagel International AG* [2014] NZHC 705 at [21]; *Commonwealth of Australia v Director, Fair Work Building Industry Inspectorate* [2015] HCA 96; 258 CLR 482 at [46]; and *Commerce Commission v First Gas Ltd* [2019] NZHC 231 at [3].

3 Attachment 1 to the Commission's "Regulatory Incentives and the Cost of Capital" 23 June 2014 (Public Version) provides a useful map of how price, quality and investment interrelate with the Part 4 purposes.

one that applied from 1 April 2015 to 31 March 2020 (although previous DPPs are also relevant).

[7] The relevant quality standard measures under the DPP are:[4]

(a) The system average interruption duration index (SAIDI). This represents the average period of outages experienced by each customer on the network during successive twelve-month periods ending 31 March (Assessment Periods). The SAIDI value is calculated by aggregating the duration of all service interruptions across all customers during the Assessment Period and dividing this by the number of customers.

(b) The system average interruption frequency index (SAIFI) is calculated by aggregating the number of all service interruptions across all customers during the Assessment Period and dividing this by the number of customers.

[8] These standards are measures of both the duration of outages and their frequency. The standards have tolerances before they are contravened. The measures recognise that outages harm customers in a variety of ways depending on the type of customer. For example, wasted product for industrial consumers, loss of revenue for service-based consumers and loss of heating and hot water for residential customers.

[9] Suppliers are expected to maintain their networks to comply with the SAIDI and SAIFI requirements. External factors that can affect service interruptions and a reasonable degree of variability in performance are accommodated in the way that the SAIDI and SAIFI measures operate. This includes the fact that a quality standard is not contravened unless a reliability assessment has been exceeded in the particular year and in either of the two preceding years.

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4 The Agreed Summary of Facts sets out more detail about the measures and how the limits are set.

The contraventions

[10] Aurora accepts it contravened the quality standards from 2016 to 2019 by exceeding the SAIDI and SAIFI limits in each of those years:

(a) In 2016, after the adjustments allowed for in the measures, Aurora's approximately 85,966 customers:

(i) experienced service interruptions of 126 minutes per customer, which was 43 minutes per customer above the SAIDI limit (exceeding the limit by 52 per cent); and

(ii) experienced 172,792 interruptions in total, which was 48,141 interruptions above the SAIFI limit or 0.56 interruptions per customer (exceeding the limit by 39 per cent).

(b) In 2017, after the adjustments allowed for in the measures, Aurora's approximately 87,102 customers:

(i) experienced service interruptions of 109 minutes per customer, which was 25 minutes per customer above the SAIDI limit (exceeding the limit by 30 per cent); and

(ii) experienced interruptions that exceeded the SAIFI limit by six per cent.[5]

(c) In 2018, after the adjustments allowed for in the measures, Aurora's approximately 88,588 customers:

(i) experienced service interruptions of 253 minutes per customer, which was 170 minutes per customer above the SAIDI limit (exceeding the limit by 204 per cent); and

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5 The Agreed Summary of Facts does not provide the same detail about this contravention because it does not materially impact on the proposed penalty because of its lower level.

(ii) experienced 281,710 interruptions in total, which was 153,257 interruptions above the SAIFI limit or 1.29 interruptions per customer (exceeding the limit by 119 per cent).

(d) In 2019, after the adjustments allowed for in the measures, Aurora's approximately 89,809 customers:

(i) experienced service interruptions of 185.5 minutes per customer, which was 102.1 minutes per customer above the SAIDI limit (exceeding the limit by 122 per cent); and

(ii) experienced 190,395 interruptions in total, which was 60,172 interruptions above the SAIFI limit or 0.67 interruptions per customer (exceeding the limit by 46 per cent).

[11] It is accepted by Aurora that its conduct in the lead up to 2016 and 2017 meant the contraventions in the 2018 and 2019 periods were virtually inevitable, even though from the end of 2017 Aurora was taking a number of steps to address its non-compliance.

[12] The lead up to 2016 began with Aurora contravening the quality standards in the 2012 Assessment Period by exceeding the SAIDI limit in 2011 and exceeding the SAIDI and SAIFI limits in 2012. The Commission did not bring proceedings against Aurora for this. It issued a warning letter instead. It also instructed consultants to report on the circumstances of the contraventions. The report:

(a) identified factors that contributed to the contraventions, including Aurora's asset management strategies and its inadequate budget for vegetation and asset management;

(b) found there were serious inconsistencies between Aurora's published and disclosed asset condition data and the asset condition data obtained by the consultants on site; and

(c) made recommendations for addressing matters.

[13] Aurora took some steps to address the findings and recommendations in the period leading up to the 2016 Assessment Periods. However, it did not have a planned response and this was not in accordance with good industry practice. Aurora's conduct in the period leading up to 2016 and 2017 was a key cause of it contravening the quality standards.

[14] Aurora accepts it failed to exercise the skill, diligence, prudence and foresight to be reasonably expected in its data management practices, its asset lifecycle management practices, its reliability management practices and its vegetation management practices. The Agreed Summary of Facts provides particulars under each of these topics.

[15] Some examples from the Agreed Summary of Facts are:

(a) failing to ensure its asset condition and fault cause data were of a sufficient standard on which to base decisions and not having independent auditing of data to pick up errors.

(b) not taking into account the condition of its assets when forecasting expenditure for replacing or renewing assets from at least 2010 to 2016;

(c) failing, without adequate justification, to spend $36.7 million of its forecast expenditure for replacing and renewing assets between 2010 and 2017 (leading to a significant proportion of Aurora's network assets being at or near the end of their lives);

(d) forming expenditure forecasts that were materially influenced by affordability rather than requirements to address identified network performance and condition risks;

(e) failing to support its investment decision-making through the use of robust technical, economic and risk analysis;

(f) failing to undertake post-event investigations into the causes of interruptions in order to avoid similar interruptions in the future;

(g) failing to increase its vegetation cutting activity at an appropriate time, which would have reduced the number and impact of vegetation faults; and

(h) failing to publish a vegetation management plan.

[16] Aurora accepts these failures caused the quality standards to be contravened or caused them to be greater than they otherwise would have been. It accepts it had knowledge of factors that increased the risk of contravention, that it failed to take the appropriate steps to address them and that, as a result, it significantly failed to exercise the skill, diligence, prudence and foresight it should have. It accepts that it knew there was a real risk of contravening the quality standards if it failed to take appropriate steps to address the factors, that it nevertheless took the risk and it was unreasonable for it do so.

Steps to address matters

[17] The Commission accepts that Aurora took a number of steps to address matters from the end of the 2017 Assessment Period onwards. It initiated, and is continuing with, a major capital works programme. Additionally, Aurora:

(a) appointed a new Chair in December 2016 and subsequently appointed a new Board and Chief Executive Officer

(b) refrained from paying a dividend and drawing on shareholder funding to finance network investment;

(c) undertook a comprehensive review of its Asset Management Plan; and

(d) implemented a structural separation of Aurora and Delta Utility Services Limited (Delta) effective from 1 July 2017.[6]

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[6] Aurora and Delta were both wholly owned subsidiaries of Dunedin City Holdings Limited and Aurora outsourced the day-to-day network management, operation and maintenance activities of its network to Delta.

[18] The remedial capital works programme required planned outages. These were a significant contributor to the 2018 and 2019 contraventions (accounting for 61 per cent of total SAIDI and 51 per cent of assessed SAIDI). When planned outages occur, the electricity distributor is able to give advance warning to consumers. Aurora accepts that, even if no planned outages had occurred, the degree of contravention would have been significant.

Financial benefit and harm to consumers

[19] The parties have not been able to agree what the overall financial effect on Aurora arising from the contraventions will be once the network is brought up to standard, including whether its underinvestment will ultimately be to its net benefit or detriment. Aurora notes that the Agreed Summary of Facts does not say that it earned a rate of return higher than the regulated rate and it therefore cannot be said that it earned excessive profits contrary to s 52A(1)(d) of the Act. Further, its remedial works will require it to incur capital and operating expenditure significantly in excess of the allowances in the current DPP. This means that it will incur significant unrecovered costs in order to remedy its poor past performance.

[20] Aurora's customers have been subject to excessive outage periods over the relevant years. The resulting loss and damage is difficult to measure but it is agreed that it is at least $8,060,000, which is the total starting point for the penalty that the parties jointly recommend to the Court (see below). In agreeing to this, and for the avoidance of doubt, Aurora does not accept that these losses support an award of compensation or damages under the Act or any other rule.

[21] Aurora has made service level payments to consumers totalling $1,045,200 during the 2015 to 2019 Assessment Periods. These are contractual payments for the outages.

The recommended agreed penalty

[22] Aurora is liable to pay pecuniary penalties under s 87(1)(a) of the Act. The maximum penalty is $5,000,000 for each contravention.[7] The maximum penalty for Aurora is therefore $20 million.

[23] In setting the penalty, the Court must take into account:[8]

(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); and

(d) whether or not the person has been found to have engaged in similar conduct by a court in proceedings under Part 4.

[24] The accepted approach in setting a pecuniary penalty is to establish an appropriate starting point for the offending having regard to the maximum penalty, and then adjusting this starting point to take into account any aggravating and mitigating factors that are specific to the defendant.[9]

[25] The proposed starting point for the 2016 to 2019 contraventions is $8,060,000 in total and is made up as follows:

(a) $4 million for the 2016 Assessment Period (80 per cent of the $5 million maximum);

(b) $3 million for the 2017 Assessment Period (60 per cent of the $5 million maximum);

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7 Commerce Act 1986, s 87(3).
8 Section 87(4).
9 *Commerce Commission v Vector Limited*, above n 1, at [23].

(c) $560,000 for the 2018 Assessment Period (11.2 per cent of the $5 million maximum); and

(d) $500,000 for the 2019 Assessment Period (10 per cent of the $5 million maximum).

[26] The parties agree that the higher starting points for 2016 and 2017 are appropriate because they reflect Aurora's significantly greater culpability leading up to and during the 2016 and 2017 Assessment Periods. The steps Aurora took to address these matters towards the end of the 2017 Assessment Period meant it was much less culpable for the 2018 and 2019 Assessment Periods.

[27] A comparison can be drawn with the penalties imposed in *Commerce Commission v Vector Limited*.[10] This is the only other case where a penalty has been imposed under s 87(1). Vector is the largest electricity distribution business in New Zealand. It contravened the prescribed quality standards for two Assessment Periods (2015 and 2016). The contraventions occurred due to a failure to follow good industry practice. Vector had not previously contravened the standards and had not previously been warned for any such contraventions. Vector made profits below the maximum permissible profit during the contravening years. Starting points of $3 million and $2.5 million were adopted in that case.

[28] The proposed starting points for Aurora in the 2016 and 2017 Assessment Periods are higher than the starting points in *Vector*. The Commission submits the difference is largely because of the higher culpability arising from the background circumstances (that is, the warning given, the report identifying matters to be addressed, and the failure to take action despite knowledge of the risks). Aurora also accepts that the starting points for the 2016 and 2017 Assessment Periods are appropriate relative to the starting points in Vector, given:

(a) the extent to which Aurora failed to meet good industry practice, the fact that it had knowledge of factors that increased the risk of

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10 *Commerce Commission v Vector Limited*, above n 1.

contravention and the fact that it did not take appropriate steps until the end of the 2017 Assessment Period;

(b) Aurora's conduct was not intentional (rather, as the Agreed Summary of Facts states, Aurora knew there was a real risk of contravening the quality standards if it failed to take appropriate steps to address the factors, it nevertheless took the risk, and it acted unreasonably in doing so); and

(c) Aurora is substantially smaller than Vector so fewer customers were impacted by Aurora's conduct and the penalty does not need to be any higher than proposed to achieve deterrence.

[29] The starting points for the 2018 and 2019 Assessment Periods are lower than the starting points in *Vector*. The Commission submits this is appropriate because Aurora was taking the steps needed to address its historic underinvestment and improve reliability by the end of the 2017 Assessment Period. The Commission submits a pecuniary penalty remains appropriate because consumers still suffered loss and unplanned outages still exceeded the SAIDI and SAIFI limits in those years. Aurora agrees its actions to address matters warrant the lower penalties. It acknowledges that its earlier conduct meant that contraventions in the 2018 and 2019 Assessment Periods were virtually inevitable.

[30] The parties propose an overall reduction of 38 per cent reduction to the starting point for mitigating factors. These factors are:

(a) Aurora's full cooperation with the investigation, including voluntarily providing information and facilitating site visits for the Commission's staff and experts;

(b) Aurora's early acceptance of liability and its early engagement with the Commission to reach a settlement;

(c) Aurora's service level payments of $1,045,200 to consumers; and

(d) Aurora's efforts to work towards future compliance, including appointing an engineering consultant (with a primary duty to the Commission) to undertake an independent review and to publish a report on that review, and its openness with the Commission regarding its plans for future compliance.

[31] This is slightly more than the discount of 35 per cent in *Vector*. Vector also cooperated with the investigation, made a similar early admission of liability and offer to settle the proceedings, made payments under its service level guarantee scheme and made efforts to work towards future compliance. The difference in percentage primarily reflects the significant commitment Aurora has shown to address its non-compliance.

[32] With a 38 per cent discount applied to each starting point, the final proposed penalty is $4,997,200 made up as follows:

(a) $2,480,000 for 2016;

(b) $1,860,000 for 2017;

(c) $347,200 for 2018; and

(d) $310,000 for 2019.

[33] The parties took the totality principle into account when reaching their agreement as to the proposed penalty and they consider the overall penalty is not out of proportion to the gravity of the overall conduct.

[34] I consider the starting points agreed upon by the parties are within the available range for the reasons they submit. As to the mandatory relevant factors, there were contraventions in four periods, significant loss, and unreasonable risk taking, but no previous findings by the Court of similar conduct.

[35] I agree that the key consideration for the 2016 and 2017 Assessment Periods is the level of risk taken by Aurora, having been warned and provided with a report

recommending actions that were not taken. A high penalty is warranted for deterrence purposes in such circumstances. I also agree that Aurora's culpability was significantly lower in the 2018 and 2019 Assessment Periods because Aurora was taking steps to address its historic underinvestment and to improve reliability. Planned outages due to these steps were a substantial portion of the amounts by which the limits were exceeded.

[36] I consider the aggregate starting points maintain proportionality to the harm Aurora's conduct caused to consumers, to Aurora's relative size as an electricity distribution business, and to Aurora's culpability assessed as a whole. They are also appropriate, relative to the starting points in *Vector*, for the reasons given by the parties.

[37] I take the same view of the proposed discount for mitigating factors. Aurora is entitled to a substantial discount for the reasons advanced. The discount proposed is appropriate relative to *Vector*, as well as to other cases where pecuniary penalties have been imposed for Part 2 and 3 Commerce Act contraventions, which were helpfully set out in Aurora's submissions.

[38] Overall I am satisfied that the proposed penalty is within range and is not disproportionate to Aurora's conduct when assessed as a whole.

Result

[39] Aurora is to pay a pecuniary penalty of $4,997,200. The parties agreed that the penalty is to be paid within 20 working days of this judgment but, in light of the COVID-19 emergency, I do not impose a specific time. The parties have leave to come back to the Court if need be when the emergency is over and if the payment has not been made in a reasonable time. Costs are to lie where they fall in accordance with the parties' agreement.

Mallon J