



High Court of New Zealand

11 December 2013

**MEDIA RELEASE – FOR IMMEDIATE PUBLICATION**

***WELLINGTON INTERNATIONAL AIRPORT LTD & OTHERS v COMMERCE COMMISSION***

**[2013] NZHC 3289 (THE INPUT METHODOLOGY APPEALS)**

**PRESS SUMMARY**

**This summary is provided to assist in the understanding of the Court’s judgment. It does not comprise part of the reasons for that judgment. The full judgment with reasons is the only authoritative document. The full text of the judgment and reasons can be found at [www.courtsofnz.govt.nz](http://www.courtsofnz.govt.nz).**

Part 4 of the Commerce Act requires the Commerce Commission to impose price control regulation on electricity lines businesses, Transpower, and gas pipeline businesses. The Commission is also required to establish information disclosure regulation for those businesses, and for New Zealand’s three international airports. The purpose of both types of regulation is to promote the long-term benefit of the consumers of the services provided by those businesses.

That regulation has now been in place for some time. As part of its work, in December 2010 the Commerce Commission made a series of decisions on the rules whereby the prices charged under price control regulation were to be established and by reference to which regulated firms would make disclosure of their financial performance under information disclosure regulation. Those rules are called input methodologies (IMs).

Part 4 provides for the regulation of suppliers in markets where there is little or no competition and little or no likelihood of a substantial increase in competition.

The purpose of Part 4 is to promote the long-term benefit of consumers in such markets by promoting outcomes that are consistent with outcomes produced in workably competitive markets so that suppliers:

- Have incentives to innovate and to invest, including in replacement, upgraded and new assets;
- Have incentives to improve efficiency and provide services at a quality that reflects consumer demands;
- Share with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and
- Are limited in their ability to extract excessive profits.

The purpose of IMs is to promote certainty for suppliers and consumers in relation to regulation under Part 4.

In this case the High Court heard and determined a series of appeals by regulated suppliers and other interested parties against the Commission's December 2010 IM determinations.

In the electricity and gas sectors, appeals were lodged by Vector and Powerco, New Zealand's two largest electricity and gas distribution businesses, and by Wellington Electricity Lines, which runs the electricity distribution network in the greater Wellington area. Transpower, the operator of the national grid, also appealed.

In the airports sector each of Auckland, Wellington and Christchurch International Airports appealed.

At the same time, appeals were lodged by two interested parties. The Major Electricity Users Group (MEUG) appealed IM decisions in the electricity sector. Air New Zealand appealed IM decisions in the airports sector.

These appeals raise a large number of complex legal, economic and corporate finance issues. The hearings of these appeals occupied 39 days over the period September 2012 to February 2013. The documents before the Court, comprising 80 volumes containing 1,055 documents of over 40,000 pages in total, were the product of the extensive consultation undertaken by the Commission over a two year period concluding in December 2012. In addition to those documents, the Court was required to consider over 2,500 pages of written submissions and over 160 documents submitted in the course of the hearings to supplement, or expand on, the parties' oral submissions (as recorded in over 5,000 pages of transcript).

The length of the Court's judgment, and the time taken to release it, reflect the size of its task.

To allow an appeal against an IM, the Court had to be satisfied that the IM proposed was "materially better" than that determined by the Commission. The phrase "materially better" is one of those legal phrases for which it is difficult to give a precise meaning. The Court noted that, for every competing argument before it, there was a supporting expert or experts. In that context the Court concluded that the "materially better" standard required it to look through the inevitable conflict and difference of views between experts, all advocating positions which they regarded as being better, and to determine whether the IM argued for was, indeed, materially better: that is, an IM which, notwithstanding that divergence of views, was sufficiently compelling to be seen by the Court as being "materially better" than that proposed by the Commission.

Whilst the Court did not agree with a number of elements of the Commission's reasoning processes, it has – with two exceptions<sup>1</sup> – dismissed all these appeals.

Two of the most important of the Commission's IM determinations were how regulated suppliers' existing specialised, that is non-land, assets were to be valued and the overall rate of return regulated suppliers in the electricity and gas sectors could earn. Regulated suppliers in that sector argued that the Commission's

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<sup>1</sup> Vector's appeal as to when controlled prices may be reviewed and the Airports' appeal as to the date at which their land is to be valued for the first time under information disclosure regulation.  
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approach undervalued those assets and allowed them an inadequate return. The Airports, which are not subject to price control and only subject to ID regulation, argued that the Commission's approach would wrongly indicate the Airports were extracting excessive profits. MEUG and Air New Zealand argued the contrary.

In dismissing those appeals, and very much in summary:

- As regards the regulatory valuation of existing, specialised, assets, the Court concluded that the asset valuation IMs would not be materially better if, as proposed by supplier appellants, they required the Commission to adopt current, replacement-cost valuations. In reaching that conclusion, and amongst other reasons:
  - (i) the Court shared the Commission's concerns as to the significance of possible revaluation gains that would arise if that approach were adopted; and
  - (ii) the Court agreed with the Commission that the valuations disclosed or determined under the regulatory regimes existing prior to the new Part 4 regime are, in that evidence was not produced to suggest they would provide less than normal returns, suitable to be used to provide opening values for existing specialised assets under the new regime.
- As regards the regulatory rate of return, or cost of capital, the Court concluded that the outcome of the approach the Commission determined provides acceptable regulatory rates of return whereas the increased rates of return proposed by suppliers would be too high and, hence, cost of capital IMs providing for such rates of return would not be materially better.

Those appeals are addressed in Parts 5 and 6 respectively of the Court's judgment.

Parts 1 and 2 of the Court's judgment set out the general background to these appeals. In Part 3 the Court discusses a number of general themes that emerged during the hearing of these appeals.

The Court deals with the rest of the appeals as follows:

- *Part 4*: Vector's appeal against the Commission's decision not to make an IM to determine the way the Commission adjusts suppliers' prices at the commencement of regulation.
- *Part 7*: Powerco's appeal against the Commission's IM for the treatment of taxation.
- *Parts 8 and 9*: Vector's appeals against the IMs dealing with:
  - (i) the allocation of costs between the regulated and non-regulated parts of its business (Part 8); and
  - (ii) when controlled prices may be reconsidered and the provision of incentives to invest over regulatory periods (Part 9).

- *Part 10:* Wellington Electricity Lines' appeal against the Commission's decision not to include proposed capital expenditure in the regulatory value of suppliers' assets.

Further details of:

- The Court's approach to what is meant by "workably competitive markets", appear at [6] and following in Part 1 of the judgment;
- Part 4 regulation, appear at [30] and following in Part 1 of the judgment;
- The appellants and the interested parties, appear at [67] and following in Part 1 of the judgment.

An appreciation of the significance of the asset values IMs may be seen by reference to Part 5.1 of the judgment at paragraph [390]. The overall impact on electricity and gas prices of the Commission's decisions applying the IMs (which decisions are not appealable) are reflected in Figures 4.1 and X2 in Part 2 of the judgment (at paragraphs [113] and [114] respectively).