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Consumer Policy
Ministry of Consumer Affairs
PO Box 1473
Wellington

by email: consumerlawreform@mca.govt.nz

SUBMISSION ON CONSUMER LAW REFORM DISCUSSION PAPER

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the Consumer Law Reform discussion paper (the **paper**) released by the Ministry of Consumer Affairs (the **Ministry**) in June 2010.

About Orion

- 2 Orion is an electricity operator for the purpose of the Electricity Act 1992. We are the electricity network provider for Christchurch and central Canterbury. Our network includes more than 14,000 kilometres of overhead lines and underground cables which deliver electricity to more than 192,000 homes and businesses, roughly 10 percent of all New Zealand electricity connections. Orion's shareholders are the Christchurch City and Selwyn District councils.
- 3 Our submission is in two parts:
 - 3.1 General comments on the paper and the current state of play,
 - 3.2 As an appendix, more detailed legal commentary on the application of the Consumer Guarantees Act to electricity.



Comments on the paper

- 4 Our submission addresses solely the matter of the application of the Consumer Guarantees Act (the **Act**) to electricity, discussed very briefly on page 109 of the paper, and ending with Question 48:

“What are your views on amending the Consumer Guarantees Act to provide that both an electricity retailer and a lines company would be liable for the quality guarantees set out in the Act.”

- 5 In brief our view is that indeed the Ministry should move to have the Act amended. However we think any amendment needs to reflect an in-depth review of the application of the Act to electricity since 2003, and in particular:
- 5.1 that the peculiar properties of electricity need to be explicitly dealt with in the Act, preferably by stating that electricity is not a good for the purposes of the Act,
 - 5.2 that the liabilities established by the courts as applying to lines companies under the Act in relation to the delivery *service* are appropriate,
 - 5.3 that any *additional* liabilities that electricity retailers face in relation to the quality of the delivery service are an *inappropriate* extension of the general application of the Act to retailers,
 - 5.4 that the Act has effectively made retailers into insurers, a role that they are not necessarily best placed to perform, and, to the extent they price-in the insurance risk, they may do so excessively, to the overall detriment of consumers, and
 - 5.5 that extending liability for distributors in the context of electricity as a good would make distributors liable in circumstances where no other supplier of a service would be liable.
- 6 We do not think it is appropriate for the Ministry to propose amendments to the Act merely to cast a wider net, or, as implied by question 48, to simply require both parties to be liable. The need is to clearly establish what it is that the parties are appropriately liable for. We also note that extending the insurance function to lines companies has the extra dimension that it is likely that the Commerce Commission’s regulatory regime will need to be amended to enable lines companies to recover this additional cost.

- 7 In more detail, we make the following observations:
- 7.1 we do not think the important aspect of the High Court decision¹ is confirmation "...that consumers should be able to seek redress from the retailer..."². Rather the important, and decidedly counterintuitive aspect of the decision is that retailer's obligations in relation to the quality of the distribution network faults and defects *is greater than* lines companies' liability with respect to those faults and defects. This seems to have arisen from the Act defining electricity as a good, while the distribution of electricity is defined as a service. Whether or not the distinction between service and good is useful, the implication that a retailer might thereby effectively be obliged to provide a network more reliable and less subject to faults and defects than the one they are in fact using – and which they have no choice but to use – is nonsensical.
- 7.2 the Court decision recognised that the retailer liability would be limited by the reasonable expectations that consumers would have of electricity supply, and specifically that it would not be entirely free of faults and defects. What it did not seem to recognise is that the relevant faults and defects almost inevitably arise in the distribution network and are virtually the *only* faults and defects that can impact on consumers. Thus the quality of the good is determined by and inseparable from the quality of the service, so if the latter is acceptable, so must the former be. To the extent that the reasonable consumer can be taken to form reasonable expectations these must be aligned with the quality delivered by lines companies acting with reasonable care and skill.
- 7.3 it is very important to note the reason for deciding that lines companies should not have an obligation to provide a network that is free of defects; it is not economically sensible to do so. The imposition of inappropriate liabilities and obligations could lead to overinvestment: so-called "gold plating" of distribution networks, leading to higher prices for all consumers.
- 8 As the attached legal review notes, most consumers will actually have little understanding of the complex set of technical interactions that bring electricity to their appliances. However we would argue that appliance

¹ Contact Energy & Ors v EGCC.

² As stated in the Paper, p109, second paragraph.

manufacturers and retailers should be able to have such an understanding. There is therefore an open question about how any party in the electricity supply chain can be liable for damage to an appliance which cannot itself be fit for purpose if it is unable to withstand the faults and defects that can reasonably be expected to occur.

- 9 Some electricity retailers have sought a contractual solution to the problem that would oblige lines companies to agree to compensate retailers where retailers are required to compensate consumers but the lines company is not at fault. We take the view that it is more appropriate for retailers to either appeal the Court decision, or seek changes to the Act. The argument about the problem being one of dealing with a monopoly provider is specious; lines companies are indeed liable where appropriate – that is, where they fail to provide a delivery service with reasonable care and skill. And the Electricity and Gas Complaints Commission scheme requires retailers and lines companies to work together to determine the appropriate party to deal with a consumer issue or complaint.
- 10 Incidentally we believe the Finance and Expenditure Committee has erred in including an attempt to address this problem by way of the Electricity Industry Bill (the Bill), where, at 45 (2) (ea) it seeks to require that terms be added to retailer's contracts with lines companies. We think the Ministry should seek to remove that clause from the Bill (or, assuming the Bill is enacted, amend the Electricity Industry Act) with a view to dealing with the problem coherently via its (this current) review of consumer law.
- 11 A key concern expressed at the time the Act was changed to apply to electricity was that consumers should not have to determine who was responsible for defects. We agree entirely. However a distinction needs to be drawn between determining the party contractually responsible, and the cause of the defect. As already noted the defect almost certainly will arise in the distribution system. That the retailer is the contractually responsible party does not excuse the lines company from liability where the lines company has indeed failed to meet its obligations under the Act.
- 12 We also urge the Ministry to consider the application of the Act, and any proposed amendments to the Act, where the lines company contracts directly with domestic consumers for the delivery service and bills them directly for that service. This actually happens in the case of the lines company called, rather confusingly in this context, The Lines Company. Any legislative solution must be robust to the various structural and contractual options open to industry players.

Concluding remarks

- 13 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Bruce Rogers (Pricing Manager), DDI 03 363 9870, email bruce.rogers@oriongroup.co.nz.

Yours sincerely

A handwritten signature in black ink, appearing to be 'BR', written in a cursive style.

Bruce Rogers
Pricing Manager

Appendix: Legal review of the application of the Consumer Guarantees Act to electricity

Electricity as a “good” – unprincipled consumer law

- 1 In 2003, the Act was amended to expressly include electricity as a “good” under the Act.
- 2 The previous government appears to have considered the change of law to be a convenient approach to ensure consumers would always have redress where their property was damaged in connection with the supply of electricity to the consumer, regardless of whether the lines company had failed to exercise reasonable skill and care in delivery. The change of law in this context simply made the electricity retailer the “insurer” in some cases. This is not principled consumer legislation.

Electricity does not have the characteristics of a “good”
- 3 Electricity does not fit well as a good in the context of other products which are clearly goods, in the context of the Act. Electricity is not manufactured in the usual sense. No specific electricity generator can be said to manufacture the electricity used by an individual consumer. Moreover the various quality attributes of electricity – for example frequency, voltage, harmonics – are common quality attributes influenced by the actions of multiple parties in the supply chain: generators, Transpower (both as grid owner and system operator), distributors, and consumers. This collective or system “manufacture” does not lend itself well to identifying the causer of any perceived “defects” in the goods.
- 4 Nor is electricity owned by an entity in the usual manner in which title to goods passes from a manufacturer to a retailer to a consumer. Lines companies never “own” the electricity, and instead merely transport it through their lines. Retailers do not in a substantive sense “own” the electricity but rather facilitate customers’ access to it through contracts under which they procure the purchase and delivery of electricity to consumers.
- 5 The nature of electricity supply is more appropriately described as a service only, not as a good as well. It is not logical or helpful to distinguish between electricity as a good and the delivery of electricity as a service under the Act. Virtually any problem with the quality of electricity will relate in some way to the delivery of it.
- 6 Electricity is similar in nature to the provision of telecommunications signals, broadband internet access or satellite television, i.e. consumers pay for the right to access a service as distinct from acquiring a product in the traditional sense. Sky Television’s satellite TV programming, Vodafone’s cellphone coverage and Telecom’s broadband internet access

are not treated as goods under the Act. Electricity is the same in nature as each of these, in the context of the Act.

Statutory guarantees do not logically extend to electricity

7 Very few of the statutory guarantees in the Act relating to goods are relevant to electricity. For example, the guarantee of acceptable quality in sections 6 and 7 refer to goods being “*durable*” and “*acceptable in appearance and finish*”, while there are guarantees as to repairs and spare parts (section 12) and title (section 5) which have no practical application in the context of electricity.

8 On the other hand, one key aspect of the guarantee of acceptable quality (which under the current regime applies to electricity as a good) is that the goods “*are free from minor defects*”. This element by itself has the potential to result in electricity retailers (under the current law) incurring significant and unjustified liability. It is illogical that it applies to electricity, given the nature of electricity supply in New Zealand is such that no electricity network can be guaranteed to not suffer outages or surges on occasions, and probably could not even if the network were “*gold plated*” at an uneconomic cost. Electricity therefore differs in an important fashion from traditional goods (such as items of clothing and personal computers) whose manufacturers can be expected to eliminate all minor defects (at least in the context of new goods or except where specific details of minor defects are brought to the attention of consumers or ought reasonably be understood).

Difficulty in defining a reasonable electricity consumer

9 Including electricity as a good under the Act imposes on electricity suppliers a standard of electricity supply expected by a reasonable electricity consumer who is fully acquainted with the state and condition of the electricity.

10 This approach does not work for two reasons. First, the supply of electricity is a complex and technical scientific concept with which few laypersons could legitimately claim to be “*fully acquainted*”. Secondly, the nature of the electricity supply in New Zealand differs widely from network to network, and depends on the consumer’s location. The reliability of electricity supply in rural areas, for example, is often significantly lower than in urban areas. It is therefore impossible for an electricity supplier (or indeed the courts) to reliably determine the expected standard of electricity supply needed to comply with the Act.

The changes have not worked as intended

11 The Commerce Select Committee, in considering the changes made in 2003, considered that in the context of electricity:

- 11.1 a reasonable consumer would “*understand that electricity is subject to momentary fluctuations, prone to interference by environmental factors and the actions of third parties, and may not be supplied at all due to planned shutdowns or emergencies*”; and
- 11.2 stated that “*we do not consider the guarantee of acceptable quality amounts to a guarantee of ‘gold plated’ supply*”.
- 12 However, it is apparent from the judgment of Miller J in *Contact Energy & Ors v EGCC* that the courts consider the electricity retailer to be strictly liable for damage from minor defects in the supply of electricity under the Act, even if a lines company could prove the minor defect was not caused by any lack of reasonable care or skill. This is contrary to the Parliamentarians’ view of how the change in law would work.
- The retailer is now effectively an insurer*
- 13 The change of law has effectively made electricity retailers the “*insurers*” of consumers’ property, through allowing consumers to seek compensation directly from retailers for damaged property where there is no fault on the part of the retailer or the lines company.
- 14 This approach fails to take into account the significant number of consumers who maintain contents insurance cover for events of exactly this nature. These consumers ultimately pay twice for insurance: first by way of their private cover, and secondly by way of the retailer passing the additional costs arising from the change of law through to consumers in the form of increased electricity prices. The position is therefore economically inefficient, and unprincipled.
- Electricity should be treated as a “service” only**
- 15 Because of the points outlined above, Orion submits that delivery of electricity should be defined as a “*service*” only under the Act, and not as a “*good*”.
- 16 There are significant advantages to this approach, including the following.
- Cost savings*
- 16.1 Having the electricity retailer or the lines company as the “*no fault*” insurer in the context of electricity results in additional cost to the industry, and, inevitably, consumers, and is unprincipled.
- The Act continues to provide significant, relevant guarantees*
- 16.2 Consumers will continue to enjoy the benefits of the statutory guarantees under the Act relating to electricity delivery services, from the lines company (be it directly or indirectly via the retailer), including the important guarantee that delivery will be carried out using reasonable care and skill (section 28). These guarantees are

directly and logically relevant to the delivery of electricity, unlike those guarantees relating to goods.

Lines companies continue to be liable for breaches of these guarantees

- 16.3 The guarantee as to reasonable care and skill applying to lines companies will continue to enable consumers directly or indirectly (via claims to electricity retailers) to recover damages from the lines company where the lines company has failed to exercise reasonable care and skill in the delivery of electricity through its lines. Orion, for example, already contractually agrees to indemnify retailers under its delivery services agreement with retailers, in respect of losses suffered by the retailers' customers arising from **Orion's** failure to exercise reasonable care and skill.

The Act will work as intended

- 16.4 In the context of goods, the Act is intended to impose strict liability on the retailer on the basis it is preferable for the retailer to determine who is to blame for damage rather than a consumer. Superficially it appears appealing to take this approach with electricity. However, as already mentioned in the case of electricity, there is no manufacturer in the traditional sense, and the lines company is only providing a service not a good.
- 16.5 With respect to traditional goods, the retailer will be strictly liable to the consumer for faulty or damaged goods. The retailer can then determine whether the fault or damage was the responsibility of themselves, the transporter or the manufacturer, i.e. pass the liability up the chain if necessary. With electricity, the retailer has no such option because those parties up the chain only provide a service (in the case of the lines company delivering electricity through their lines) or cannot produce damaged or faulty goods (in the case of the electricity generator).

The specialist independent dispute resolution scheme continues

- 16.6 Consumers will continue to have access to the specialist independent dispute resolution scheme operated by the Electricity and Gas Complaints Commissioner. This scheme includes all major retailers and lines companies, and ensures a consumer does not need to seek redress via the courts directly from retailers or lines companies themselves (where there is often an imbalance of resources), where there has been a breach of the statutory guarantees relating to electricity delivery services by a retailer or lines company.

Electricity suppliers would be treated equitably

- 16.7 There may be a view that electricity should be treated differently than other similar services (such as broadband internet or telecommunications signals) because electricity can cause damage to consumers' property. However, consumers can still suffer loss from these other similar services, often of an amount greater than any electricity damage to property. If broadband internet or telecommunications signals fail, consumers can suffer loss through being unable to access the Internet or use their phones (for example, missing cheap flight bookings on the Internet). Treating electricity as only a service will ensure electricity suppliers are treated consistently with providers of broadband internet or telecommunications.

If electricity is to remain a "good"

- 17 Despite the very good reasons for amending the Act to treat electricity only as a service, if it is considered that electricity must remain a "good" under the Act, Orion submits that consumers' recourse should remain solely against the electricity retailer with whom they have contracted where there has been no lack of reasonable care or skill by the lines company. This is on the basis that the electricity retailer has the relationship with the consumer and is best placed to manage that relationship, and the lines company has nothing of value to add.
- 18 Neither retailers nor lines companies are well placed to act as insurers. Neither party is likely to be in a position to assess the risk and consequences of claims anything like as well as an insurer. Both are likely as a result to overstate risk, and therefore price it too high. This is inefficient and bad for consumers.
- 19 However there is no benefit and some cost in transferring the insurance function from retailers to distributors. There will be additional transaction costs for both parties in relation to claims, so total costs of this solution will be higher. Moreover retailers will face competitive pressures to minimise costs associated with the insurance function; distributors will not face such pressures.
- 20 The above reasoning is also applicable to the proposal under the Electricity Industry Bill (clause 45(2)(ea)) that the Electricity Industry Participation Code require lines companies to indemnify retailers in respect of liability under the Act for breaches of acceptable quality of supply as a good. We have opposed, and will continue to oppose this proposal. This particular provision fails to take into account the nature of electricity. It is also unclear what is meant by "faults" on the network and whether this is intended to only capture faults covered by a lines company failing to exercise reasonable care and skill in providing the service, or, for example, whether it is intended to cover fault events caused by third parties such as cars hitting poles.