

# COMMERCE COMMISSION

## BRIEFING FOR INCOMING MINISTERS

October 2005

### Legislation enforced by the Commerce Commission

Commerce Act 1986	Commerce Act
Credit Contracts and Consumer Finance Act 2003	CCCF Act
Dairy Industry Restructuring Act 2001	DIR Act
Electricity Industry Reform Act 1998	EIR Act
Fair Trading Act 1986	Fair Trading Act
Telecommunications Act 2001	Telecommunications Act

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## EXECUTIVE SUMMARY

- The Commerce Commission is an independent Crown entity. It is a quasi-judicial body established under the Commerce Act and is not subject to direction in its enforcement and regulatory control activities. The Commission performs its functions within statutory frameworks and does not advise the Government on policy matters.
- Under s 26 of the Commerce Act, the Minister of Commerce can communicate to the Commission statements of economic policy, which the Commission must have regard to in its decisions under the Commerce Act.
- The Commission has a wide range of tools at its disposal. The way it achieves its outcomes will depend on the most suitable tool for the job, be it competition law, consumer law, or regulatory control.

### Purpose and outcomes

- The purpose of the Commission is to promote dynamic and responsive markets so that New Zealanders benefit from competitive prices, better quality and greater choice.
- Its activities are targeted to achieve three key outcomes: competitive markets, informed consumers, and sound regulation.
- The Commission promotes competitive markets by taking action against anti-competitive arrangements and investigating possible unlawful aggregations of market power. It can authorise arrangements that might lessen competition if it judges that the benefits to New Zealanders would be likely to outweigh the detriments.
- To foster informed consumers the Commission provides information to businesses and the public, takes action against misleading behaviour, and ensures consumers receive accurate and legally required information under consumer credit contracts.
- The Commission works to achieve sound regulation in the telecommunications, electricity distribution, gas distribution and dairy industries.
  - In telecommunications regulation the Commission determines access to networks, limits the exercise of market power, and calculates and allocates the cost of Telecommunication Service Obligations.
  - In electricity regulation the Commission administers a targeted control regime for electricity lines businesses and administers an information disclosure regime.
  - In gas regulation the Commission controls the price and quality of Vector and Powerco's gas pipelines services. The former Minister of Energy has directed that a targeted control regime be introduced for all gas pipelines businesses. Implementation of the regime is dependent on legislation.
  - In dairy regulation the Commission ensures compliance with the Dairy Industry Restructuring Act and makes determinations to resolve disputes.

### Legislative frameworks

- The Commission operates under a number of general and specific regulatory regimes set out in the: Commerce Act 1986, Fair Trading Act 1986, Electricity Industry Reform Act 1998, Telecommunications Act 2001, Dairy Industry Restructuring Act 2001 and Credit Contracts and Consumer Finance Act 2003.
- The Commission may require individuals and businesses to provide information and/or appear before it to answer questions, and has search and seizure powers, from routine inspection powers to the obtaining and execution of search warrants.

#### *Commerce Act (Vote Commerce)*

- To promote competition for the long term benefit of consumers the Commission takes action against anti-competitive arrangements and the misuse of market power, and can authorise anti-competitive arrangements if the benefits to consumers outweigh the detriments.
- The Commission is currently seeking to clarify s 36 of the Commerce Act relating to abuse of market power by pursuing cases where the Commission considers there has been an abuse of market power.
- The Commission is promoting increased use of its Leniency Policy which gives amnesty to cartel members who co-operate with investigations. Four applications for leniency have been received since the Policy was introduced in late 2004. The Commission is currently prosecuting a cartel in the chemicals industry.

#### *Electricity Lines Businesses (Vote Energy)*

- Under the Commerce Act the Commission administers a targeted control regime for electricity lines businesses which sets price and quality thresholds and may control the prices, revenue and/or quality of a business that breaches those thresholds. Since the regime was introduced, around two-thirds of distribution businesses have reduced their prices in real terms.
- The Commission also administers an information disclosure regime for electricity lines businesses and a full review of this is in progress.
- The Commission published an intention to declare control of Unison Networks in September 2005. This is the first time such a declaration has been made.

#### *Gas Pipelines Industry (Vote Energy)*

- Under the Commerce Act the Commission administers direct control of gas pipeline services for Powerco and Vector to ensure they are limited in their ability to earn excessive profits, and the quality of their services is maintained.
- The Minister of Energy has directed that a thresholds regime be introduced for all gas pipelines businesses, the implementation of which is dependent on legislation.

#### *Fair Trading Act (Vote Commerce)*

- The purpose of the Fair Trading Act is to encourage competition and protect consumers from misleading and deceptive conduct and unfair trading practices.

- As Fair Trading Act breaches become more sophisticated and complex, and where they have widespread public detriment, the Commission is taking an industry-wide approach to the resolution of issues.
- Fair Trading priority areas for 2005/2006 include motor vehicles, financial services, new immigrant businesses, cross-border breaches, misleading price representations and food and dietary-related claims.

*Credit Contracts and Consumer Finance Act (Vote Commerce)*

- The Act seeks to protect the interests of consumers who obtain credit, ensure they have accurate information, and provide for contracts to be varied on the grounds of unforeseen hardship.
- The Commission assumed responsibility for enforcing Act in April 2005. Priority areas for enforcement are: ensuring that creditors provide to debtors the information required by the Act; ensuring that disclosure meets the standards set out in the Act; ensuring that debtors are not unreasonably required to take out credit related insurance; and ensuring that fees are reasonable.

*Telecommunications Act (Vote Communications)*

- The Act's purpose is to regulate the supply of Telecommunications services.
- The Commission is currently monitoring Telecom's progress in reaching two broadband targets and determining the net cost of Telecom's telecommunication service obligations for the 2003/04 and the 2004/05 financial years.
- In 2005 the Commission began a review of the services regulated under the Act, to determine whether regulation should be extended.
- The Commission is finalising an application from TelstraClear for access to the wholesale bitstream services which was regulated following the Commission's unbundling report.
- In August 2005 the Communications Minister asked the Commission to reconsider its recommendation to the Minister on mobile termination.

*Electricity Industry Reform Act (Vote Commerce)*

- The Act's purpose is to ensure that electricity prices are subject to downward pressure and that efficiencies are passed on to all classes of consumers. This is achieved by separating electricity distribution from generation and retail: distribution companies can only generate or retail electricity if these parts of the business are separate corporate entities and operated at arm's length.
- The Commission has enforcement and adjudication powers under the Act and is able to exempt parties from the application of the Act.
- The Commission is currently considering applications from electricity lines companies Eastland Infrastructure Limited and Unison Networks Limited for exemptions in relation to proposed involvement in renewable energy generation. Commission is also considering five exemption applications from the

owners of commercial buildings and shopping centres, as they are captured by the Act.

#### *Dairy Industry Restructuring Act*

- In dairy regulation the Commission ensures compliance with the Dairy Industry Restructuring Act and makes determinations to resolve disputes.

#### Structure and resources

- The Commission currently comprises six members: Paula Rebstock (Chair), David Caygill (Deputy Chair), Douglas Webb (Telecommunications Commissioner) and Denese Bates QC, Donal Curtin and Peter Taylor (Commissioners). Roy Hemmingway, Anita Mazzoleni, Gowan Pickering and Shaan Stevens are Associate Members of the Commission and Fiona Bolwell and Terence Stapleton are Cease and Desist Commissioners.
- The Commission has 141 staff at offices in Wellington, Christchurch and Auckland. Its General Manager is Geoff Thorn. A number of internal management and infrastructure projects are planned for 2005/2006. These relate to strategic planning; review of policies and procedures; and new or enhanced systems in financial management, project management and human resources management.
- The Commission's 2005/2006 budget is \$19.7 million (GST exclusive). In addition to its operating budget, the Commission has access to an 'Other Expenses' appropriation of \$3.367 million (GST exclusive) for the 2005/2006 financial year to fund the direct costs of major litigation activity. The services of the Commission are purchased primarily by the Government through the above appropriations of public money. The Commission also administers a full cost-recovery approach for some of its regulatory control work under the Telecommunications Act.

## **Purpose**

The purpose of the Commerce Commission is:

*To promote dynamic and responsive markets so that New Zealanders benefit from competitive prices, better quality and greater choice.*

This purpose definition represents the Commission's view of its various statutory responsibilities. Each statute has its own purpose statement. The Commission has interpreted the underlying thrust of each piece of legislation to arrive at its overall purpose.

## **Role and Membership**

The Commission is a body corporate established under s 8 of the Commerce Act and is a Crown entity under Schedule Four of the Public Finance Act 1989.

The Commission is independent and is not subject to direction from Ministers or the Executive in carrying out its enforcement and regulatory control activities.

The Commission has responsibility for a number of general and specific regulatory regimes under the Commerce, Fair Trading, Electricity Industry Reform, Telecommunications, Dairy Industry Reform and Credit Contracts and Consumer Finance Acts. The Commission's activities cover enforcement (investigations, litigation, and the provision of information to the public) and regulatory control (adjudications and reports to Ministers).

The Governor-General, on the recommendation of the Minister of Commerce, appoints Commission Members for their knowledge of and experience in areas relevant to the Commission's interests. At least one Commission Member must be a barrister or solicitor. The Telecommunications Act created the position of Telecommunications Commissioner, who is a member of the Commission and is appointed by the Governor-General on the recommendation of the Minister. The Minister of Commerce may appoint Associate Members.

The Governor-General may also appoint up to two Cease and Desist Commissioners who must be barristers or solicitors. These Commissioners are appointed for the sole purpose of hearing and determining applications for cease and desist orders.

The Commission currently comprises six Members: Paula Rebstock (Chair), David Caygill (Deputy Chair), Douglas Webb (Telecommunications Commissioner) and Denese Bates QC, Donal Curtin and Peter Taylor (Commissioners). In addition, Roy Hemmingway, Anita Mazzoleni, Gowan Pickering, and Shaan Stevens are Associate Members of the Commission and Fiona Bolwell and Terence Stapleton are Cease and Desist Commissioners. A full list of Commissioners, including biographical information, is included in Appendix 2.

Each Commission Member's Warrant of Appointment sets out the start date and duration of the term of appointment. This term can be extended with the Chair's approval to deal with work still in progress.

The Chair convenes meetings of the Commission and may direct the Commission to sit in divisions in relation to certain matters. The Deputy Chair may exercise all the powers, functions and duties of the Chair, in the event the Chair is unable, or considers it improper, to act.

The Commission may delegate its powers to any Commission member, except for the power of delegation and the power to grant, revoke, or vary an authorisation made under the Commerce Act.

The Commission has its own conflict of interest policy. Commission Members must be alert to, and disclose all actual or perceived conflicts of interest. If in any doubt, Commission members must exempt themselves from the item under discussion, disclose the conflict to a Commission meeting, and discuss the issue with the Chair. A register is maintained of the conflicts disclosed by Members.

### **Accountability and Transparency**

The Commission is accountable in two principal ways: through specific reporting obligations (supplemented by voluntary reporting); and through the courts in relation to its adjudication decisions.

Each year the Commission enters into an Output Agreement with the Responsible Minister (the Minister of Commerce) and Purchase Ministers (the Ministers of Commerce, Communications and Energy) that sets out the basis on which the Commission will receive funding from the Crown and the outputs it will produce with that funding. The Output Agreement specifies the undertakings against which the Ministry of Economic Development monitors the Commission's performance in output delivery.

The Commission reports to Parliament annually as required, and also to the Ministry of Economic Development by way of confidential quarterly reports. Each quarter, the Commission reports in terms of its overall financial performance and capability, and against five appropriations and one Non-Departmental Other Expenses appropriation:

- Enforcement of General Market Regulation (Vote Commerce);
- Enforcement of Dairy Sector Regulation (Vote Commerce);
- Enforcement of Telecommunications Sector Regulation (Vote Communications);
- Enforcement of Electricity Sector Regulation (Vote Energy);
- Regulatory Control Inquiry: Gas Pipeline Services (Vote Energy); and
- Commerce Commission Litigation Fund (Vote Commerce).

The reports include information on matters currently under investigation by the Commission. The Commission also provides confidential extracts of its quarterly reports to the Ministries of Agriculture and Forestry and Consumer Affairs, as the agencies with responsibilities in the dairy sector and fair trading areas.

The Commission prepares an Annual Report, including audited financial statements, that is tabled in the House of Representatives. The Commission also publishes a Statement of Intent that sets out its intended activities for the next three years.

Regular contact is maintained between the Commission and the Ministries of Economic Development, Consumer Affairs and Agriculture and Forestry, and with other departments and agencies as required, such as the Electricity Commission and the Securities Commission.

All of the Commission's adjudication decisions (which are published) can be appealed to the High Court. Unlike most tribunals, however, the Commission normally appears in support of its decisions in the High Court and Court of Appeal. The Commission's role in these appeals is to 'help the Appellate Court to whatever extent the Commission and that Court find consistent with the Commission's public responsibility'.<sup>1</sup>

In its enforcement role, the Commission is able to resolve investigations through administrative means, such as issuing warnings to, and entering into settlements with businesses. Where the Commission decides it is appropriate to prosecute a business, it is required to establish its case before the courts.

The Commission's responsibilities in the telecommunications, electricity, dairy and gas sectors are funded by industry levies collected by the Government. The Commission's reporting processes have been refined to accommodate the additional information needs created by the industry levies.

## **Independence**

Consistent with its independence, the Commission does not advise the Government on policy matters. It performs its enforcement and regulatory control functions within the relevant statutory framework. The independence of the Commission is necessary to enable the Commission to apply its operational policies and reach decisions fairly and consistently and in accordance with the objectives of the Acts, without influence by individual Ministers or the Government as a whole.

Section 26 of the Commerce Act provides a formal and transparent mechanism for the Minister of Commerce to communicate to the Commission the economic policies of the Government – *"In the exercise of its power under this Act, the Commission must have regard to the economic policies of the Government as transmitted in writing from time to time to the Commission by the Minister."*

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<sup>1</sup> Goodman Fielder Limited v CC [1987] 2 NZLR 10,20 (CA)

The courts have established that, consistent with its independence, the Commission must have regard to such statements, but is able to form its own views as to the actions or decisions that are appropriate in each case, consistent with the relevant legislation.

### **Crown Entities Act 2004**

A significant focus for the Commission is the new reporting provisions required by the Crown Entities Act, more specifically the presentation of a Statement of Intent which will apply from the 2006/2007 financial year. The Commission voluntarily moved early to reporting via a Statement of Intent, and prepared its first Statement of Intent for the 2005/2006 financial year.

### **Trans-Tasman Harmonisation**

The New Zealand and Australian Governments have confirmed their desire for closer harmonisation of competition law and policy. The Australia New Zealand Leadership Forum, which was created by the two governments to advance trans-Tasman dialogue, has established a competition and consumer issues working group. The working group, which represents New Zealand and Australian businesses with significant interests in trans-Tasman trade, is chaired by Commerce Commission Chair Paula Rebstock, with secretariat support from the Commission. The group is working on identifying priorities for action for further co-ordination of the trans-Tasman competition and consumer regimes. These will be put to officials for consideration in 2006.

In the meantime, the Commission has further developed its relationship with the Australian Competition and Consumer Commission in the development of proposed joint guidelines on genetically modified foods and also leniency policies. The Commission has also responded to an MED discussion paper which examines ways of enhancing information gathering and sharing between the ACCC and the Commerce Commission.

### **Commission Powers**

In carrying out its functions, the Commission is able to require companies and individuals to provide information and to appear before the Commission at a specified time and place to give evidence. Such evidence may be taken on oath. The Commission also has the power to obtain search warrants from the District Court, and to make orders declaring certain information to be confidential.

#### *Power to obtain information*

In the course of carrying out its activities the Commission can require businesses and individuals to:

- furnish in writing any specified information or class of information;
- produce any specified document or class of documents and/or;
- appear before the Commission at a specified time and place to give evidence, and
- produce any specified documents or class of documents.

These powers are set out in s 98 of the Commerce Act and have been incorporated into the Telecommunications, DIR, EIR and CCCF Acts. The Commission has similar information gathering powers under s 47G of the Fair Trading Act, although for the purpose of ascertaining whether someone has engaged in contravening conduct, it cannot under that Act require a person to appear before it to give evidence.

#### *Search warrant powers*

The Commission has the power to obtain and execute search warrants. A search warrant, issued by the District Court, gives the Commission powers to:

- search specified premises, seize and remove goods, documents, computer records and other items;
- enter premises, with force if necessary; and/or
- obtain assistance in the search from, for example, the police or computer experts.

The owner or occupier of premises being searched must provide the Commission's staff with reasonable facilities and assistance when they execute a search warrant. This includes:

- assisting them to identify and locate the information required; and
- assisting them to reproduce information stored or recorded such as computer records.

The Telecommunications Act qualifies the Commission's general power by confining the power to search to those situations where the Commission suspects that a party has failed to provide required information or has misled the Commission. The Fair Trading Act empowers the Commission also to search for the purpose of investigation or obtaining evidence of the nature or extent of contravening conduct.

#### *Section 100 orders*

When carrying out its functions, the Commission gains access to confidential or sensitive material. The Commission is provided with wide powers to control access to such information. Under s 100 of the Commerce Act, the Commission is given the power to order people not to disclose specified information given to the Commission during an investigation. Section 100 applies this power to any information, document or any other evidence (for example, photographs or statements made to the Commission).

To support the effect of a s 100 Order, s 100(4) of the Commerce Act makes it an offence for anyone, including the Commission and the owner of the information, to publish or communicate the information covered by the s 100 Order. The s 100 Order may state the period for which it remains in effect. If the s 100 Order does not specify any time period, it will remain in effect until the investigation is finished.

Under s 100(3) of the Commerce Act, the Official Information Act 1982 will not apply to the information listed in the order until after the s 100 Order has expired. Section 100 is incorporated into other relevant legislation, excluding the Fair Trading Act.

### *Injunctions*

Under s 81 of the Commerce Act and s 41 of the Fair Trading Act, and ss 96 to 98 of the CCCF Act, the High Court has the power to grant injunctions to stop people breaching, attempting to breach, encouraging other people to breach and being involved in breaches or conspiring with others to breach the legislation. The injunctions can be temporary or final.

Non-compliance with an injunction is rare and anyone who fails to comply will risk being in contempt of court. The court has wide powers to ensure compliance with an injunction and can impose fines, seize property or imprison.

### *Leniency Policy*

In November 2004, the Commission released a Leniency Policy specifically aimed at breaking cartel behaviour. The purpose of the Policy is to offer immunity from Commission initiated proceedings to the first person involved in a cartel to come forward with information about the cartel and co-operate fully with the Commission.

Cartels involve secretive, collusive behaviour such as price fixing and merchant sharing. These arrangements are very difficult to detect. Overseas agencies have found that providing incentives for cartel members to break the cartel is critical to enforcement. The Leniency Policy aligns the Commission with competition agencies worldwide, most of whom offer comparable policies.

The Commission has received four applications for leniency since the Policy's introduction.

### *Co-operation Policy*

Also in November 2004, the Commission released a new Co-operation Policy. The effect of the Policy is that the Commission, in respect of all its enforcement responsibilities, will exercise its discretion to take a lower level of enforcement action, or no action at all, against an individual or business in exchange for information and full continuing and complete co-operation. A lower level of enforcement action may include a settlement, or a submission made by the Commission to the court for a reduction in penalty on behalf of an individual or business. An agreement by the Commission to proceed under this Policy does not prevent third party action.

### *Cease and Desist Orders*

The Commerce Amendment Act 2001 provided specific powers to the Commission to obtain cease and desist orders against anti-competitive behaviour. Cease and desist orders can only be made by specially appointed Cease and Desist Commissioners who are to be barristers or solicitors of at least five years' standing.

Orders can be made to stop cartel behaviour, including deals between competitors to set the price of goods they compete in, market rigging, or joint action by a group of businesses to block competitors coming into the market. Orders can be made to stop

arrangements between businesses that have the effect of lessening competition, such as discounting arrangements. Orders can also be made to stop exclusive dealing in certain circumstances by parties with market power.

A Cease and Desist Commissioner may make a cease and desist order if satisfied that a prima facie case has been made that a business has breached either the restrictive trade practices or prohibited business acquisition provisions of the Act.

In seeking a cease and desist order, the Commission must be satisfied that it is necessary to act urgently:

- to prevent a particular business or consumers from suffering serious loss or damage:
- in the interest of the public.

## Capability and Resourcing

### *Capability Building*

In recent years the Commission has grown in size and responsibility and has strengthened its capability in order to deliver on a broader range of outputs. The challenge for the Commission is to achieve market-driven solutions that in turn deliver increased market effectiveness.

The trend of increasing complexity and volume of the Commission's work continues. This complexity has been driven by the Commission's expanded role, changes in the competition thresholds and the content of investigations, and an increase in external expectations.

In 2004 the Commission launched its Strategic Plan for 2004-2007. The Strategic Plan was a catalyst for the Commission to refocus on all areas of its role and responsibilities, and was the result of a strategic review involving consultation with stakeholders.

In 2004/2005 the Commission, in conjunction with MED, Treasury, and other appropriate parties, participated in four separate reviews of the Commission's funding arrangements. Two key reviews were the baseline review of the Commission's activities under Vote Commerce (enforcement of General Market Regulation) and a review of the Non-departmental other expenses Commerce Commission Litigation Fund. For the 2005/2006 financial year the base appropriation under Vote Commerce has increased \$4.26 million (GST exclusive) and the base appropriation for the Litigation fund has increased \$1.87 million (GST exclusive). In addition to the \$1.87 million allocated to the Litigation Fund, the Ministers of Finance and Commerce have the delegated joint authority to transfer any unspent litigation fund appropriation from the 2004/2005 year to the 2005/2006 year.

### **Resourcing for 2005/2006 and Beyond**

The Commission has offices in Wellington, Christchurch and Auckland and has 141 staff. The Commission's operating budget is \$19.7 million (GST exclusive), through five output appropriations (previous three years shown below). The Regulatory Control Inquiry within Vote Energy was a two year project spread over three financial years and the report was presented to the Minister in November 2004.

The figures shown are the full appropriations.

<b>Vote</b>	<b>Appropriation</b>	<b>2005/06 \$m (GST excl)</b>	<b>2004/05 \$m (GST excl)</b>	<b>2003/04 \$m (GST excl)</b>
Commerce	Enforcement of General Market Regulation	12.602	9.671	8.992
	Enforcement of Dairy Sector Regulation	0.905	0.905	1.252

Communications	Enforcement of Telecommunications Sector Regulation	3.500	3.500	3.500
Energy	Enforcement of Electricity Sector Regulation	2.667	2.667	2.667
	Regulatory Control Inquiry – Gas Pipeline Services	-	0.400	1.350
<b>TOTAL</b>		<b>19.674</b>	<b>17.143</b>	<b>17.761</b>

The Commission also earns income from Commerce Act fees, interest and cost recovery from Applicants for access determinations under the Telecommunications Act. In addition to its operating revenue, the Commission is able to draw against a Non Departmental Other Expenses appropriation (the Litigation Fund) of \$3.367 million (GST exclusive), for the 2005/2006 financial year, for managing significant litigation cases that meet stated criteria.

Most of the Commission's activities under the three sector-specific regimes (dairy, electricity and telecommunications) are funded in the first instance by the Crown by way of appropriation, and ultimately by participants in each sector by way of levy set and collected by the administering department – the Ministries of Economic Development or Agriculture and Forestry. Under the DIR Act, some of the Commission's activities are funded solely by the Crown.

## Key Governmental Relationships

The Commission has a number of key relationships with Ministries.

### *Ministry of Economic Development (MED)*

MED leads the preparation and co-ordination of policy advice related to economic, regional and industry development, including competition and economic regulatory policy. MED is the Government's primary adviser on the operation and regulation of specific markets and industries, including energy and telecommunications. MED has a key role in monitoring the performance of the Commission.

### *Ministry of Consumer Affairs (MCA)*

MCA has the responsibility for providing advice to the Government to establish the policy and legislative framework that support consumer protection. It has the primary role helping consumers understand their rights.

### *Ministry of Agriculture and Forestry (MAF)*

MAF is responsible for providing advice to the Government to establish the policy and legislative framework in relation to the regulation of the dairy industry, specifically the operation of Fonterra.

## **International Relationships**

The Commission has agreements with several regulatory or competition bodies in other countries.

### *Australia, Canada, Taiwan and United Kingdom*

The Commission has co-operation arrangements with the Australian Competition and Consumer Commission, the Canadian Competition Bureau and the Taiwan Fair Trade Commission. In the United Kingdom it has co-operation arrangements with Her Majesty's Secretary of State for Trade and Industry and the Office of Fair Trading (OFT).

The agencies share information as allowed by existing privacy and confidentiality laws, co-ordinate enforcement activities where appropriate and avoid any conflict in enforcement action. The Commission is currently in negotiation with the United States Federal Trade Commission in relation to a similar arrangement.

### *International Co-operation*

As a member of the OECD, New Zealand complies with the 1986 recommendations on international co-operation relating to the notification of investigations or proceedings to other member countries if their interests may be affected. The criteria are whether an investigation or proceeding relates to the conduct of a person resident or carrying on business in another member country, or whether the conduct is likely to have an effect on competition in a market in another member country. The Commission is a member of the International Competition Network, which is an association of enforcement agencies.

## VOTE COMMERCE

### Commerce Act

The Commerce Act is a set of generic competition laws that prohibit anti-competitive market behaviour or structure in any market. The Act prohibits: contracts or arrangements by businesses that could lead to a substantial lessening of competition; the taking advantage of substantial market power to deter or eliminate competition; and mergers or acquisitions that would substantially lessen competition. The Commerce Act also provides for the regulatory control of goods or services in specified markets.

The Electricity Industry Reform Act, introduced in 1998, seeks to reform the electricity industry to better ensure that costs and prices in the electricity industry are subject to sustained downward pressure; and the benefits of efficient electricity pricing flow through to all classes of consumers by effectively separating electricity distribution from generation and retail; and promoting effective competition in electricity generation and retail.

The Commission carries out enforcement and regulatory control activities, primarily focussing on investigations and adjudications under the Commerce Act and the EIR Act, as well as providing general information to both businesses and consumers about their rights and obligations under the legislation. The Commission also publicises the results of its enforcement activities and its adjudication decisions to inform businesses and deter them from breaching the Act.

#### *Enforcement*

Enforcement activity has been identified as a priority area in the Commission's Strategic Plan. There is a need to increase the Commission's enforcement impact under the Commerce Act as resources over the last two years have been diverted away from these areas due to an increase in adjudication cases.

The Commission's current focus under the Commerce Act is on cases that have the most impact, such as cartel conduct, and on identifying cases that will best progress the interpretation and enforcement of s 36 (abuse of market power), in light of the Privy Council decision in *Carter Holt*<sup>2</sup>. To this end, the Commission is giving priority to leniency applications and to resolving some long-standing cases.

The Commission recently updated its Leniency Policy to assist in the detection of anti-competitive cartel behaviour. The Commission will grant immunity from Commission initiated proceedings to the first person to co-operate fully with the Commission. This policy has had a significant impact.

The Commission's enforcement tools include investigations, litigation and the provision of public information. Investigations are selected and decisions taken about how to

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<sup>2</sup> *Carter Holt Harvey v Commerce Commission*, Privy Council Appeal No 6, 14 July 2004

resolve investigations, including whether to take court action, according to the Commission's enforcement criteria.

General market enforcement deals with investigations into market structure and market behaviour activities.

### Market behaviour investigations and proceedings

The number of Commerce Act enforcement investigations resolved last year was 28. Although short of the planned 40–50, considerable resources were consumed by a small number of important cases such as the chemicals cartel, which included two criminal prosecutions for misleading the Commission. The Leniency Policy also had an impact as resources were diverted to deal with applications for leniency when they were made. Jurisdictional issues also delayed investigations in cases involving companies without an actual presence in New Zealand.

Challenges to the Commission's exercise of statutory powers and processes are becoming increasingly common. During the year considerable resource has been devoted to ensuring that the Commission has robust processes and policies for dealing with issues such as leniency applications, the exercise of statutory information gathering powers and the gathering of electronic evidence. These are essential to the success of the Commission's enforcement activities.

The Commission currently has on hand 34 Commerce Act matters for enforcement and is progressing court proceedings on further six cases. Four significant matters are summarised below.

### **Health Sector Investigations**

The Commission is concerned at the number of cases coming to its attention regarding potential breaches by health sector professionals and service providers of the restrictive trade practice provisions of the Commerce Act. It appears to the Commission that some of these groups either have no knowledge of the provisions of the Commerce Act or may consider that the Act does not apply to their business activities.

An application for clearance to merge by Sonic Healthcare Ltd and New Zealand Diagnostic Group revealed evidence of a potential price fixing agreement between the two in markets for the supply of pathology laboratory services. The two appear to be competitors and have jointly tendered for two contracts with District Health Boards. A market behaviour investigation was opened and is ongoing. The application for clearance to merge was declined by the Commission.

Current pathology services contracts expire in September 2005 in nearly every DHB region. Many DHBs are now looking towards an alternative funding model and there appears to be a trend towards single-provider, bulk-funded contracts for the provision of pathology services. Commission staff met with staff from the Ministry of

Health and the Ministry of Economic Development to discuss the issues. As a consequence the Ministry of Health sent a letter to all DHB's outlining the Commission's concerns.

In another case under investigation it is alleged that New Zealand Diagnostic Group and Pathology Associates Ltd have agreed a market sharing arrangement with the local DHB in respect of pathology services in the Waikato region.

The Commission is working towards settlement with a group of ophthalmologists who have admitting fixing the prices they charge the local DHB for their services. This is the second group of ophthalmologists the Commission has taken enforcement action against for anti-competitive behaviour.

Finally, ACC has entered into a contract with Southern Cross Hospitals and Auckland Orthopaedics Limited (AOL) to carry out ACC-funded elective surgery at three of Southern Cross's hospitals in Auckland. AOL is a company representing over 40 Auckland orthopaedic surgeons. The Commission is investigating the contract to determine whether AOL, or its shareholders, have entered into an arrangement to collectively set the fees for providing orthopaedic surgery services under the ACC contract.

## **Chemicals**

After a three year investigation, the Commission filed civil proceedings against four New Zealand companies and four Australian companies, and seven officers and ex-officers of these companies, in relation to alleged anti-competitive practices and cartel activity in the timber preservatives industry.

The activity is alleged to have taken place in Australia and New Zealand. The allegations include sharing prices, price fixing, collusion, bid-rigging, attempting to exclude a new entrant, and subsequently attempting to eliminate the new entrant from the market.

Criminal proceedings have also been taken against two individuals. One individual pleaded guilty to misleading the Commission, another is before the courts for allegedly misleading the Commission. Criminal and civil proceedings are ongoing.

The New Zealand companies are Koppers Arch Wood Protection (NZ) Limited, Osmose New Zealand Limited, TPL Limited, and Nufarm Limited. The Australian companies are Koppers Australia Pty Limited, Nufarm Australia Limited, Osmose Australia Pty Limited, Koppers Arch Investments Pty Limited.

## **Telecom – data tails**

On 18 March 2004, the Commission filed High Court proceedings under the Commerce Act against Telecom Corporation of New Zealand and Telecom New Zealand Limited

alleging that Telecom misused its market power, and continues to do so, to prevent or deter competition in markets involving high speed data transmission.

On or about 1 December 1998, Telecom introduced new pricing for its retail high-speed data transmission services (termed ‘Streamline’), and in March 1999 Telecom introduced new wholesale pricing (termed carrier data pricing (CDP)).

Through CDP, Telecom provided and continues to provide other telecommunication service providers competing with Telecom with two wholesale data service options:

1. the ability to resell Telecom’s retail high-speed data transmission services (both dedicated and switched); and
2. access to dedicated data tails in Telecom’s network in order to supplement the other telecommunications service providers’ own networks and, thereby, provide retail high-speed data transmission services.

The Commission alleges that in almost all circumstances, the price charged by Telecom for access to data tails required by other providers to supplement their own network exceeds:

- the price charged by Telecom to the telecommunication service provider for an ‘end to end’ data service, when provided for re-sale;
- the comparable retail price charged by Telecom for provision of comparable data services;
- the price Telecom charges itself for access to the data tails; and
- the sum of Telecom’s direct incremental cost and opportunity cost of supplying access to the data tails.

### Market structure investigations

Where it considers that market behaviour may risk breaching the Commerce Act, the Commission can undertake market structure investigations focused on business transactions that have not been, or are not intending to be, notified for clearance or authorisation. In 2004/2005 the Commission began 20 such market structure investigations and resolved 14.

In addition to investigations, the Commission maintains a surveillance programme where merger and acquisition activity is identified and assessed against high level criteria. A large number of acquisitions are assessed in this way.

### *Adjudication*

Under the Commerce Act, the Commission considers clearance applications for proposed business acquisitions, and applications for authorisation of certain prohibited contracts or arrangements that would normally be considered a breach of the Act. The Commission

will grant an authorisation if it finds that the benefits of the acquisition or arrangement outweigh the detriments.

The Commission handles approximately 25-30 clearances a year. On average two to three of these are declined each year.

### **Electricity Industry Reform Act**

The Commission considers applications for exemption from certain requirements of the EIR Act.

Presently, the Commission is considering five exemption applications from the owners of commercial buildings and shopping centres, as they are technically considered to be cross involved under the EIR Act. The Commission is also considering applications from Eastland Infrastructure Limited and Unison Networks Limited, both electricity lines companies, for exemptions in relation to proposed involvement in renewable energy generation.

### **Fair Trading Act**

The Commission carries out enforcement activities under the Fair Trading Act and the Credit Contracts and Consumer Finance Act in order to ensure that consumers are confident of the accuracy of the information they receive when making choices. Enforcement activities include providing information and guidelines to businesses, professional/trade associations and consumers to enable and improve compliance; issuing warnings and entering into settlements; and taking court action.

The Fair Trading Act prohibits misleading and deceptive conduct, misrepresentations and unfair practices such as bait advertising and pyramid selling. It also gives the Commission enforcement responsibility for a number of regulations relating to consumer information and product safety standards.

In general terms, Fair Trading breaches are becoming more sophisticated and complex. The Commission has responded by reviewing its enforcement criteria to ensure that the most serious cases are targeted and by taking an industry-wide approach to the resolution of issues rather than a case by case approach. It has also targeted cases where the Fair Trading Act is better able to deal with competition issues than other legislation, typically by ensuring that consumers have the information on which to base their purchase decisions. The Commission has also developed a compensation policy and will seek redress for affected consumers where appropriate.

Going forward, the Commission will continue to take action in its priority areas and focus on areas where actions against an individual or company can be leveraged to achieve behavioural changes across an industry, such as health and nutrition, or a constituency,

such as immigrant businesses. The Commission will also continue to improve its ability to address cross-border breaches by working with overseas agencies.

Priority areas for 2005/2006 include telecommunications, immigrant businesses, cross-border breaches, misleading price representations and health and dietary-related claims.

Major Fair Trading cases currently being pursued by the Commission include: prosecution of credit card providers over non-disclosure of foreign exchange transaction fees; prosecution of Qantas and Air New Zealand over the advertising of airfare prices; prosecution of Carter Holt Harvey, for alleged mis-grading of timber used in construction.

#### *Motor Vehicle Information Standard Regulation*

In December 2003, the Commission received responsibility for enforcing a new Consumer Information Standard promulgated under the Fair Trading Act. The new standard requires motor vehicle traders to display a Supplier Information Notice (SIN) on all used vehicles to which the regulations apply. This includes most vehicles offered or displayed for sale by motor vehicle traders and through car fairs and markets, and via the internet (where a contract to purchase the vehicle can be entered into over the internet).

The SIN provides a mechanism by which consumers can obtain accurate information about used motor vehicles in order to make informed purchasing decisions. Displaying information in a consistent manner also promotes competition by allowing consumers to make accurate comparisons between vehicles.

A review of these provisions is being conducted by the Ministry of Consumer Affairs during 2005/06.

#### *Guidelines and Codes of Practice*

From time to time the Commission develops guidelines for businesses or comments on industry codes of practice to assist compliance the Acts it enforces. Most recently it has commented on codes produced by the real estate industry, and developed a draft guideline on GM-free labelling as a result of the Royal Commission on Genetic Modification. The Commission released its draft guideline in June 2004, and received more than 75 submissions. It is now working with the Australian Competition and Consumer Commission to develop a joint Australasian guideline for industry.

#### *Immigrant Business Strategy*

The growth in immigrant communities has created a number of challenges for the Commission including:

- ensuring businesses are aware of and understand their obligations under the Fair Trading Act;
- promoting awareness of the Act amongst new immigrant consumers, informing them of their rights and the course of action open to them for remedying breaches; and

- promoting the functions of the Commission including enforcement action.

The Commission is implementing information and enforcement strategies for ensuring compliance with the Fair Trading and CCCF Acts amongst immigrant communities. Translations of the Commission's Fair Trading Guide will be published in the 2005/2006 year, and the Commission is also developing contacts with groups such as Auckland's Chinese Chamber of Commerce.

#### *Cross-border breaches*

New Zealand consumers are increasingly being targeted by overseas rogue traders, both over the internet and through more traditional channels. The Commission has developed strong relationships with its Australian and other international counterparts to more effectively target these traders. The agencies share information about current scams, traders of concern, current and past enforcement action and methods of enforcement and the Commission has also assisted international agencies by taking affidavits from affected consumers for use in overseas prosecutions, serving documents and participating in international internet sweeps.

### **Credit Contracts and Consumer Finance Act**

The CCCF Act repealed the Credit Contracts Act 1981 and the Hire Purchase Act 1971. It provides a modernised framework for regulating credit transactions and consumer leases, and includes particular provisions relating to property buy-back transactions. The major provisions of the Act came into force in April 2005.

The Commission is now in the early days of enforcing the CCCF Act, with 14 investigations opened, of which four have resulted in warnings. The major issues under investigation include the reasonableness of fees, the calculation of early prepayment fees, failure to meet disclosure standards and unreasonable requirement to obtain insurance.

#### *Information*

The Commission provides general information to both businesses and consumers about their rights and obligations under the legislation it enforces, and publicises the results of its enforcement activities to deter other businesses from breaching the Act. It also works with individual businesses and industry/professional groups where there appear to be systemic issues to encourage them to implement or improve their compliance systems.

The Commission obtains information about potential breaches of the law from both its own surveillance and inspection activity and from the public. Through its Contact Centre it receives some 15,000 contacts each year from the members of the public who are concerned about consumer-related issues and it is estimated that 3,000-4,000 of these raise prima facie breaches of the Fair Trading Act.

Investigations are selected and decisions taken about how to resolve investigations according to the Commission's enforcement criteria.

The Commission completes approximately 400 investigations per annum and has, on average, 60 investigations open at any one time. In the 2004/2005 year, the Commission completed 312 general fair trading investigations and 142 standards investigations; approved 18 cases for criminal prosecution; and concluded 14 criminal prosecutions and three civil actions.

## **Dairy**

The Commission has both enforcement and quasi-judicial responsibilities under the Dairy Industry Restructuring Act 2001. The Commission:

- investigates those aspects of the behaviour of Fonterra Co-operative Group Limited that appear to breach the conditions for the entry and exit of potential and existing farmer shareholders or any regulations made pursuant to the Act; and
- considers applications for determinations from parties in dispute with Fonterra concerning the entry and exit provisions, or any regulations made pursuant to the DIR Act (currently regulations relate to the supply and pricing of raw milk to independent processors). The Commission's determination must specify the actions required of any party, or actions from which a specified party is required to refrain.

In addition, the dairy industry is subject to general market regulation under the Commerce and Fair Trading Acts. The Commission has available to it the full range of enforcement powers under those Acts.

The Commission actively monitors the dairy industry, and continues to enhance its understanding of, and the implications arising from, the DIR Act and related legislation.

### *Issues*

#### Parallel court proceedings

On 27 July 2005 the High Court issued its judgement on the proceedings brought by Fonterra concerning the interpretation of the Dairy Industry Restructuring (Raw Milk) Regulations 2001 (Raw Milk Regulations).

The first proceeding related to Fonterra's application for a declaration that 'new co-op retention' as defined in regulation 8(6) of the Raw Milk Regulations does not include the amount of Fonterra's after-tax loss. Retention is a component of the formula used to calculate the default price of milk paid by independent processors. Retention is defined in the Raw Milk Regulations as "after tax profit". In the 2001/2002 season Fonterra incurred an after-tax loss of \$50,000,000 and recorded that amount as retained earnings in its annual accounts, but used nil as the new co-op retention in the calculation of the default price of raw milk. The High Court held that Fonterra's after tax loss does not fall within the definition of retention.

The second proceeding also involved an application for a declaration on statutory interpretation. This followed Fonterra's abandonment of its judicial review of the Commission's decision setting the discount rate. The discount rate is used in calculating the annualised share value which is a component in the calculation of the default milk price. Under the Raw Milk Regulations, the Commission is required to set a discount rate for calculating the annualised share value in circumstances where Fonterra does not use a cost of capital rate in calculating the price of a co-operative share. Fonterra had used a weighted average cost of capital. The Commission argued that in order to be consistent with the purpose of the Raw Milk Regulations a cost of equity capital should be used. The High Court applied a literal interpretation of the Regulations and held that it was appropriate to use a weighted average cost of capital.

The Commission has appealed the decision of the High Court on both these issues.

#### Determination: Open Country Cheese Company

In September 2004, the Commission received an application from the Open Country Cheese Company Limited for a determination under the DIR Act relating to the transport component of the default milk price for raw milk that Open Country purchases from Fonterra under the Raw Milk Regulations. Under the Raw Milk Regulations when independent processors elect to purchase milk at the default price Fonterra can charge them the reasonable cost of transporting the raw milk to that independent processor. This is the Commission's second ever application to resolve a dispute under the DIR Act.

Under the DIR Act, the Commission considers applications for determinations from parties in dispute with Fonterra. There is no statutory time frame for completing the determination other than it must be completed as soon as practicable.

In the draft determination the Commission reviewed Fonterra's current method of calculating the reasonable transport cost. Fonterra applies a national-average based transport charge. The Commission's preliminary finding is that a national-average based transport charge is not reasonable and that, if the draft view is confirmed, Fonterra would be found to be in breach of the DIR Act. The Commission held a conference on 16, 17 and 18 August 2005 and expects to release its final determination in October 2005.

## VOTE COMMUNICATIONS

### Telecommunications

The Commission has three major functions under the Telecommunications Act. These are to:

- resolve access disputes between carriers;
- oversee the Telecommunications Service Obligations (TSO) regime and apportion the annual costs between carriers; and
- monitor the regulatory regime and recommend to the Minister changes (either additions, modifications or amendment) to the list of regulated services.

Within the Commission, the Telecommunications Commissioner has primary responsibility for implementation of the regime. The Telecommunications Commissioner and two other members of the Commission, appointed by the Chair, must make certain determinations. In other cases the Telecommunications Commissioner undertakes the functions, but may request two other members to assist.

The Commission considers applications for determinations to resolve disputes relating to access terms and conditions. An access seeker or a provider of a designated or specified service may apply to the Commission to determine access pricing and other terms for designated and specified services and designated multi-network services. The Commission will issue determinations setting the terms and conditions of access in the case of designated and specified services, and specifying the functions and cost formula for specified multi-network services. The Commission has a statutory discretion, in some circumstances, not to investigate an application.

In conjunction with the Telecommunications Act 2001, the Kiwi Share Obligation was updated to become a Telecommunications Service Obligation (TSO) for Local Residential Service (LRS TSO). The LRS TSO, as set out in the LRS TSO Deed, requires Telecom to meet detailed service quality measures and report to the Crown and the Telecommunications Commissioner.

The Commission is required annually to determine the net cost to Telecom of providing LRS TSO services to commercially non-viable residential customers in compliance with the LRS TSO Deed. The LRS TSO services are detailed in the LRS TSO Deed, and include basic telephone access, free local calling and dial-up internet access.

A second TSO was recently introduced – the Telecommunications Relay Service (TRS TSO) for people who are deaf, or who have speech or hearing impairments. The TRS TSO Deed specifies the amount of cost for which the provider will be reimbursed.

The Commission annually assesses whether telecommunications service providers (currently Telecom New Zealand Limited and Sprint) have complied with the conditions contained in the TSOs and reports to the Minister on non-compliance. The Commission will also provide a copy of the report to the relevant telecommunications service

provider. Non-compliance will be considered during the Commission's allocation of costs of the TSO to all liable persons.

The Telecommunications Act provides for the Minister of Communications to request the Commission to prepare a report to the Minister on whether additional telecommunications services should be designated or specified, or whether existing classifications should be amended. The Commission may also decide to conduct an inquiry and prepare a report to the Minister.

In addition, the telecommunications industry is subject to general market regulation under the Commerce and Fair Trading Acts. The Commission has available to it the full range of enforcement powers under those Acts.

### *Issues*

#### **Broadband Services**

##### Broadband Monitoring

The Commission began its broadband monitoring following Telecom's announcement last year that it will have no fewer than 250,000 residential broadband connections (minimum 256 kbps downstream and 128 kbps upstream) by the end of 2005, of which more than a third (approximately 83,000) will be wholesale Jetstream or bitstream products.

As at the end of June 2005, Telecom had achieved 82.4 percent of the connection target with a total of 205,927 residential broadband connections. Of this number, 30,283 were wholesale connections, representing 36.5 percent of the wholesale target.

##### Unbundled Bitstream Services

The Commission is currently considering an application from TelstraClear for access to the wholesale bitstream service which was regulated following the Commission's unbundling report. The bitstream access service enables other carriers to utilize Telecom's asymmetric digital subscriber line (ADSL) infrastructure to deliver broadband services to end-users.

The Commission released its draft determination on an application by TelstraClear for regulated access to Telecom's bitstream service in April.

The Commission's preliminary view was that Telecom should provide TelstraClear with a bitstream access service available nationally with characteristics which differ from Telecom's current commercial bitstream service. The regulated bitstream service will allow TelstraClear to provide higher speed, differentiated ADSL broadband offerings to consumers using Telecom's ADSL platform.

The Commission will shortly finalise its decision on the wholesale bitstream service. The decision will be of wider importance to Internet Service Providers which are interested in obtaining access to high speed bitstream as an input to their own broadband products.

#### Telecommunication Service Obligations

In March 2005, the Commission announced its calculation of Telecom's net cost of complying with TRS TSO for the period from 1 July 2002 to 30 June 2003. The Commission calculated the net cost at \$57 million.

The Commission is preparing draft determinations on the net cost to Telecom of meeting its TSO obligations for the 2003/04 and 2004/05 financial years, which it expects to release in December. The Commission is also preparing a draft determination on the allocation among the industry of the cost to Sprint of providing the TRS TSO for the same years. The Commission expects to release the draft determination in December 2005.

The Commission advised the Minister of Communications that Telecom New Zealand had complied with its obligations under the TSO for 2003/04.

#### Access Determinations

##### **Interconnection**

The Commission completed its first interconnection determination in November 2002. The interconnection price is the charge payable by one carrier to the other for handling various calls between the two networks. The Commission set the interconnection price for standard calls between the Telecom and TelstraClear networks at 1.13 cents per minute. That price is still in effect.

Telecom and TelstraClear sought a review under the Telecommunications Act of the initial price set by the Commission. The Act provides for a review by the Commission of its initial decision, based on a detailed investigation of the efficient costs of providing interconnection services in New Zealand. The initial decision was based on benchmarking of the prices of similar services provided to telecommunications carriers in comparable countries. The Commission released a draft report in April, which set an interconnection price of 1c per minute. The Commission will finalise its determination in November.

##### **Wholesale**

In May 2003, the Commission made its final determination relating to the supply of Telecom retail services on a wholesale basis to TelstraClear. This determination largely relates to business services and residential broadband.

The Commission's determination ordered that these services are to be made available by Telecom for resale to TelstraClear customers. The Commission set a wholesale price of 16 percent off Telecom's standard retail prices.

Telecom and TelstraClear sought a review under the Telecommunications Act of the initial discount set by the Commission. The Act provides for a review by the Commission of its initial decision, based on a detailed investigation of the costs avoided by Telecom when the retailing function is performed by another carrier. The initial decision was based on benchmarking of discounts provided for similar wholesale services in comparable countries.

The Commission also made a determination in respect of wholesaling of residential local access and calling services in June 2004. The Commission set the discount for price capped services at 2 percent as required by the Act, and at 16 percent for non-price capped services. The parties sought a review of this determination.

The Commission released a principles paper on how the discounts should be calculated in April 2005. The Commission has been gathering additional data, and expects to release a draft Determination in early 2006.

TelstraClear has also applied for a determination in relation to additional wholesale services which support broadband applications, in particular Telecom's Private Office Networking service. A draft Determination was released in August 2005 and a final Determination is expected to be released in November 2005.

### Industry Forum

The Commission may approve telecommunications industry codes submitted by the telecommunications industry forum. The Commission may consult with the industry before approving a code.

The Forum sought approval for a code on the co-location of mobile network equipment. After reviewing the code, the Commission advised the Forum that there were a number of important elements missing from the Draft Code. As a result of these omissions, the declined to approve the code.

### Number Portability

Telephone number portability, the ability to retain the same phone number when switching providers, increases competitive pressure by reducing the barriers to changing provider. TelstraClear, Callplus Limited, Compass Communications Limited, ihug and WorldxChange Communications Limited applied to the Commission in July 2003 for a determination of the formula for how the cost of providing number portability should be apportioned between participants in Number Portability Services. The Commission considered the application in conjunction with the development of codes covering operational and technical matters by the Industry Forum.

Subsequently an application was received by the Commission seeking a determination of the functions and standards applying to cellular and local number portability.

The Commission issued a determination on cost allocation and the functions and standards in August 2005. Industry participants are required to provide number portability on the terms set out in the determination by 1 April 2007.

### Mobile Termination

The Commission commenced an investigation in May 2004 into wholesale mobile termination rates. Mobile termination rates are the fees mobile network operators charge other telecommunications companies to terminate calls on the mobile networks. Mobile termination is a significant input into the provision of retail fixed to mobile and mobile to mobile services.

In June 2005, the Commerce Commission recommended to the Minister of Communications that the termination of fixed line voice calls on a cellular telephone network should be regulated. However, the Commission specifically excluded from its recommendation voice calls using third generation (3G) mobile technology.

In August, the Minister of Communications requested that the Commission reconsider its recommendation.

The Minister asked the Commission to:

- give further consideration to the definitional and implementation issues concerning 2G and 3G which have been identified by submitters;
- consider the commercial offers made to him by Telecom and Vodafone following the Commission's final report, in comparison to regulation;
- give further consideration to how best to ensure that end-users benefit from reductions in wholesale mobile termination rates.

The reconsideration is underway and is expected to be completed by the end of 2005.

### Review of regulated services

The Telecommunications Act includes specific telecommunications services regulated by the Commission. These services are regulated under the Act for a term of five years. Before a service reaches the end of its fixed term of regulation, the Commission must assess whether the service should continue to be regulated. If the Commission is satisfied that there is not a competition problem for a particular service, the service will no longer be regulated. Where the Commission decides to investigate an extension, the Commission will either recommend extending or not extending the term of regulation. If the Minister accepts a recommendation to extend the period, regulation of the service will

be extended for two years. If the Commission doesn't recommend an extension, the service will no longer be regulated under the Act after the end of its five-year term.

Thirteen services were available when the Act came into force. These services are scheduled to expire on 19 December 2006, unless the Minister of Communications accepts a recommendation from the Commission to extend the period of regulation of any or all of these services. Two services relating to bitstream access that were added in 2004 are in force until 2009 and are not dealt with in this review.

## **VOTE ENERGY**

The Commission has responsibility for electricity sector regulation under the Electricity Industry Reform Act 1989 and Part 4A of the Commerce Act (Part 4A).

In addition, the electricity industry is subject to general market regulation under the Commerce and Fair Trading Acts. The Commission enforces the Electricity Industry Reform Act as part of its general market regulation activities. The Commission has available to it the full range of enforcement powers under those Acts.

### Electricity Lines Businesses

Part 4A of the Commerce Act gives the Commission responsibilities for the regulation of 29 electricity businesses (28 distribution businesses and Transpower). The Commission's responsibilities include:

- developing and administering a targeted control regime for electricity lines businesses by:
  - setting thresholds for the declaration of control of line services (The Commission set its initial thresholds in June 2003);
  - assessing lines businesses against those thresholds;
  - determining whether to declare regulatory control; and
  - controlling, if necessary, the prices, revenues and/or quality standards of line services of any lines businesses in breach of the thresholds;
- developing and administering an information disclosure regime under which electricity lines businesses must publicly disclose financial and other performance information;
- undertaking a comprehensive audit of optimised deprival valuation (ODV) asset valuations of all electricity lines businesses (the audit has been completed); and
- undertaking a review of asset valuation methodologies for lines business system fixed assets.

### Targeted control regime

The purpose of the targeted control regime is to promote the efficient operation of markets directly related to electricity distribution and transmission. The regime achieves long-term benefits for consumers by ensuring that suppliers:

- are limited in their ability to extract excessive profits;
- face strong incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
- share the benefits of efficiency gains with consumers, including through lower prices.

After extensive consultation with interested parties, the Commission set two thresholds in June 2003, a price path threshold and a quality threshold. The Commission's price path threshold follows the 'CPI minus X' formulation commonly used for price control in other jurisdictions, where prices must stay within a band linked to the Consumer Price Index.

Two rounds of assessment against thresholds have been undertaken. At the first assessment date the Commission identified 13 out of the 29 lines businesses had breached their price-path thresholds. Of the 13 breaches, 8 were technical in nature requiring no further action and post-breach inquiries were opened into four others. One organisation (Transpower) was required to resubmit its compliance statement to the Commission in an alternative form.

One post-breach inquiry resulted in an intention to declare control of Unison Networks Limited which was published on 9 September 2005. The Commission must now consult upon its intention, including through a public conference, and have regard to the views of interested parties before it may proceed to declare control. The public conference is scheduled for November 2005.

In the three remaining post-breach inquiries the Commission is determining whether to proceed to publish an intention to declare control. The Commission has also opened a post-breach inquiry in respect of Transpower's breaches of its price-path threshold at both the first and the second assessment dates. The inquiry is ongoing.

With regard to the second assessment against both the price path and quality thresholds, six businesses were found to have complied with the thresholds, six were found in breach, and the Commission has requested further information from the remaining 16 businesses to complete its assessments.

While six businesses were identified as having breached the thresholds, no further action by the Commission was necessary due to the nature of the breaches. The price path threshold breaches were principally attributable to differences between budgeted and actual transmission costs, and were not symptomatic of pricing behaviour detrimental to consumers. The quality threshold breaches were found to be caused by 'extreme' events that resulted in uncharacteristic drops in reliability, such as severe storms.

The Commission is still reviewing all 28 self assessments to establish criteria for normal and extreme events and to evaluate the ways in which the businesses communicate with consumers.

#### Information disclosure by electricity lines businesses

In March 2004 the Commission published its Electricity Information Disclosure Requirements 2004, largely replicating the previous requirements administered by MED, and in March 2005 the Commission released the data and a rudimentary analysis of information disclosed by the 28 electricity distribution businesses and Transpower for the 2004 disclosure year. The Commission will work towards developing its analysis to show

the businesses' relative performance and the changes in performance over time. A comprehensive review of the Information Disclosure Requirements is in progress.

A key financial performance measure is the Return on Investment which requires robust asset values as a component. The finalised Optimised Deprival Valuation (ODV) Handbook, which prescribes the methodology for valuing the system fixed assets of electricity distribution businesses and forms part of the disclosure requirements, was issued on 30 August 2004 and came into effect on 31 August 2004. The Commission is currently developing an updated ODV Handbook for Transpower.

### Responsibility for Transpower

The Commerce Commission and the Electricity Commission have shared responsibility for the regulation of Transpower. The Commerce Commission promotes the efficient operation of markets directly related to transmission services, through targeted control for long-term benefit of consumers. The Electricity Commission ensures electricity is generated, conveyed and supplied to all classes of consumers in an efficient, fair, reliable and environmentally sustainable manner.

Notwithstanding these different objectives, there is a risk of overlap in the operation of these areas:

- Pricing of goods and services. The Commerce Commission sets and administers price path thresholds and can put Transpower under control. The Electricity Commission authorises Transpower's pricing methodology and prescribes terms and conditions regarding connection to the national grid.
- Quality of electricity. The Commerce Commission sets and administers quality thresholds. The Electricity Commission sets quality and security standards for the transmission system or parts of the transmission system, or for the use of that system.
- Electricity information disclosure requirements. The Commerce Commission makes publicly available information about the operation and behaviour of large line owners. The Electricity Commission makes publicly available information regarding Electricity Governance Regulations and Rules.

The consistency of approach in these and other areas is managed by way of a (draft) Memorandum of Understanding between the two Commissions and by the appointment of the Chair of the Electricity Commission as an Associate Member of the Commerce Commission

The Commerce Amendment Act (No 2) 2004 provides for the possible transfer to the Electricity Commission of the Commerce Commission's jurisdiction regarding Transpower. This requires consultation with and a recommendation from each

Commission and consultation with industry participants and consumers. The transfer may be effected at any time by a recommendation from the Minister of Energy.

## **Gas**

### *Gas pipelines industry*

The Commerce Commission began an inquiry into gas pipelines services in April 2003 following a request from the Minister of Energy under the regulatory control provisions of the Commerce Act. The Minister requested the Commerce Commission to make recommendations on whether or not supply of gas transmission and distribution services should be controlled.

The Commission delivered its Gas Control Inquiry Final Report to the Minister of Energy in November 2004. The Minister accepted the Commerce Commission's recommendation and announced that the Commission would begin administering direct control of Powerco and Vector's gas pipelines services from 25 August 2005, and that a targeted control regime would be introduced for the gas pipelines industry as a whole. The implementation of this regime is dependent on legislation.

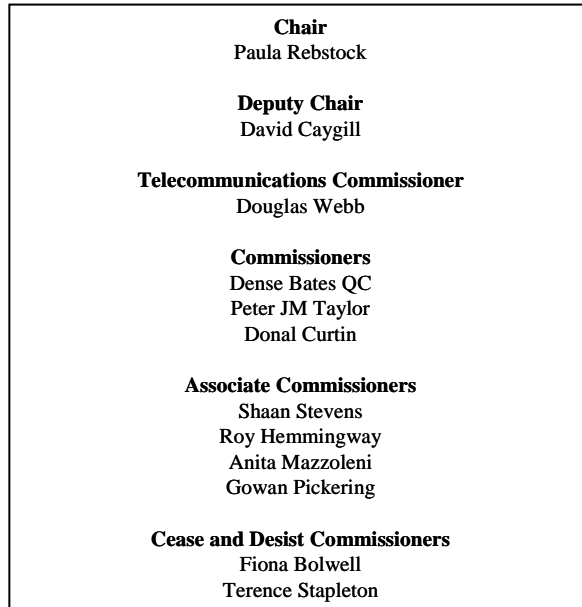
### *Control of Powerco and Vector gas pipelines services*

The Commission issued a Provisional Authorisation to implement control over the gas pipeline services of Powerco and Vector from 25 August 2005. This requires Powerco to ensure that its average price for controlled services as at 1 October 2005 is at least 9% lower than the average price charged at 30 June 2005. For Vector the average price as at 1 October 2005 must be at least 9.5% lower than the average price charged at 30 June 2005.

The Commission is now working towards developing a final authorisation, which will involve public consultation upon the appropriate form of control. Gas retailers have been requested to explain how they intend to pass through the reduced prices to consumers. There is likely to be a delay between the effective date for the reduction in distribution prices (1 October) and the date at which pass-throughs are implemented (likely to be 1 November). One retailer, Contact, has indicated that it would cost more to reconcile and pay this timing difference than the benefit that consumers would receive and so they do not intend to adjust their pricing to take account of it. The Commission is still following up on responses.

**APPENDIX 1**

**Structure of the Commerce Commission**



<b>General Manager</b> Geoff Thorn
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<b>Networks Branch</b> <i>Director</i> Michael Clark	<b>Competition Branch</b> <i>Director</i> Glenn McDonald	<b>Economic Services Branch</b> <i>Chief Economist</i> Michael Pickford	<b>Corporate Services Branch</b> <i>Director</i> Glen Maguren	<b>Legal Services Branch</b> <i>General Counsel</i> Peter R Taylor	<b>Fair Trading Branch</b> <i>Director</i> Deborah Battell
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<b>Network Access Group</b>	<b>Market Behaviour Group</b>
<b>Network Performance Group</b>	<b>Market Structure Group</b>

<b>Communications</b>
<b>Finance</b>
<b>Human Resources</b>
<b>Information</b>
<b>Communications</b>

<b>National Office</b>
<b>Auckland</b>
<b>Christchurch</b>
<b>Wellington</b>

## APPENDIX 2

### Commerce Commission Members

#### *Paula Rebstock – Chair*

Paula Rebstock was appointed Chair in December 2003 for a term of three years. She was initially appointed as an Associate Commissioner for three years from August 1998, and as a Commissioner, including a period as Deputy Chair, for a further four years in July 2000. Paula formerly held positions at the Department of Labour, Department of the Prime Minister and Cabinet and at The Treasury. Paula was a former Director of the Foundation for Research, Science and Technology. She is the Chair of Local Media Group Limited and is an economic consultant.

#### *David Caygill – Deputy Chair*

David Caygill was appointed Deputy Chair in December 2003 for a term of five years. David is a solicitor and was until recently a partner in Buddle Findlay. His governance experience includes chairing the Grid Security Committee, the Electricity Governance Establishment Group and the Accident Compensation Corporation. More recently he has been a member of the State Services Commission's Crown Entities Review Panel and the Review of the Centre Advisory Group. David is a Director of Infracore and Chair of the Pegasus Health group of companies.

#### *Douglas Webb – Telecommunications Commissioner*

Douglas Webb was appointed Telecommunications Commissioner in March 2002 for a period of five years. He was most recently the Managing Counsel and deputy to the Vice President in the Legal Department at the World Bank. He has over 30 years of legal experience, including 16 years as a partner in a national law firm and 14 years as a specialist on legal system reform in developing countries.

#### *Denese Bates QC – Commissioner*

Denese Bates was appointed in April 2004 for a period of five years, having been initially appointed in 2001. She has been practising as a barrister since 1981 and was appointed as a Queens Counsel in 1996. Her practice has encompassed a wide range of litigation before courts and tribunals and she has been counsel in a number of landmark cases. Denese has a long involvement as a council member of both the Auckland District Law Society and the New Zealand Law Society. She was for two years the convenor of the New Zealand Law Society's Ethics Committee.

#### *Donal Curtin – Commissioner*

Donal Curtin was appointed in January 2001 for a period of three years. In November 2002, he was appointed a full member of the Commission for a period of three years. He is a business economist with wide experience of applying economics to commercial decisions. Born in Ireland, Donal worked there and in the United Kingdom in a variety of economic roles. He came to New Zealand in 1985 and during a career with the Bank of New Zealand was its Chief Economist and head of its national private banking unit. In

May 2002 he was appointed by Parliament's finance and expenditure select committee to advise it on monetary policy. He is an economic consultant.

*Peter JM Taylor – Commissioner*

Peter Taylor was appointed in February 2001 for five years. He trained as a chartered accountant, with experience in Africa, the United Kingdom, Australia and Asia. He was a consulting partner of a major New Zealand accountancy firm for 14 years, managed that firm's Wellington office and was a director for six years. From 1994-96 he was on secondment to the Crown Company Monitoring and Advisory Unit as Chief Executive. Peter is currently Chair of the Public Trust and Martin Jenkins and Associates Limited; Deputy Chair of New Zealand Venture Investment Fund Limited; a Director of Port Marlborough New Zealand Limited and Avon Investments Limited and a member of the Marsh Limited Advisory Board.

*Shaan Stevens – Associate Commissioner*

Shaan Stevens was appointed in November 2002 for three years. He is both a Barrister and Chartered Accountant and holds a number of public sector and private sector governance roles. He is the Pro Chancellor of Victoria University, a Member of the Foundation for Research Science & Technology TechNZ Reference Group and the TechNZ Maori Specialist Reference Group and a member of the Asia External Reference Group for the Ministry of Foreign Affairs & Trade. Shaan is of Ngati Kahungunu and Ngati Raukawa descent and is active in Maori economic development. He also works with the Guinness Gallagher Group, an international consultancy firm that provides advice to the World Bank, ADB and governments/organisations in the Asia Pacific region.

*Roy Hemmingway – Associate Commissioner*

Roy Hemmingway was appointed in June 2004 in respect of Part 4A (electricity thresholds regime) matters under the Commerce Act. His appointment runs until 14 September 2006 to coincide with the expiry date of his Electricity Commission term. Before taking up his appointment as Chair of the Electricity Commission in September 2003, Roy was Chair of the Public Utility Commission in the State of Oregon, USA. He spent most of his 30 years in Oregon working in the public sector on matters involving electricity. He served as a policy advisor to three Oregon governors and was a key figure in establishing the Northwest Power Planning Council, a four-state electricity planning body. In the private sector, he worked as a consultant to the electricity industry in Oregon and Washington.

*Anita Mazzoleni – Associate Commissioner*

Anita Mazzoleni was appointed in May 2005 for three years. She is a corporate finance adviser with experience of large public and private sector corporates, having worked as General Counsel at Contact Energy, Corporate Finance Manager at ECNZ, General Manager at Citibank, and as Taxation Solicitor at Fletcher Challenge. She currently

provides independent corporate finance and funding advice to businesses and government agencies in New Zealand and the Pacific.

*Gowan Pickering – Associate Commissioner*

Gowan Pickering was appointed in May 2005 for three years. For over three decades he operated in the information technology industry for IBM. This culminated in his seven year appointment as the New Zealand IBM Chief Executive Officer and Chairman from 1991 – 1998. In this period he oversaw the integration of IBM New Zealand into a world-wide management system. He was Chief Executive for the Foundation for Research, Science & Technology for four years from 2000. He is the Chair of Wellington Free Ambulance, a Director of Fishserve NZ Limited and a Council member of the Victoria University of Wellington.

*Fiona Bolwell – Cease and Desist Commissioner*

Fiona Bolwell was appointed in March 2002 for five years. She is an experienced litigator who practises as a barrister in the commercial law and taxation area. She was Crown Counsel for six years and was a partner at Cooney Lees and Morgan in Tauranga. During her career as Crown Counsel, she acted as senior counsel for several major Court of Appeal cases and appeared as junior counsel before the Privy Council.

*Terence Stapleton – Cease and Desist Commissioner*

Terence Stapleton was appointed in March 2002 for five years. He is a former member of the Commerce Commission, and is a barrister. He has a close involvement with the New Zealand Law society's litigation skills training programmes. He is also a commercial mediator and arbitrator and is a Councillor of the Arbitrators' and Mediators' Institute. He was the Crown Solicitor at Gisborne from 1979 to 1987.