

COMMERCE COMMISSION

BRIEFING FOR INCOMING MINISTERS

December 2004

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 was established under the Commerce Act 1986. It is a Crown entity under Schedule Four of the Public Finance Act 1989.
- In response to a changed environment and its increase in responsibilities, the Commission has reviewed its Strategic Plan, including its purpose, values and strategic goals. In May 2004, the Commission launched its Strategic Plan for 2004-2007.
- 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.
- The Commission is an independent quasi-judicial body and is not subject to direction in its enforcement and regulatory control activities. It has responsibility for enforcement and regulatory control under a number of general and specific regulatory regimes set out in the: Commerce Act, 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.
- 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's activities cover enforcement (investigations, litigation, and the provision of information to the public) and regulatory control (adjudication and reports to Ministers).
- An Output Agreement is signed with the Minister of Commerce as the Responsible Minister, and the Ministers of Commerce, Communications and Energy as the Purchase Ministers. The Output Agreement specifies what the Commission will deliver with its funding, and the basis on which the Ministry of Economic Development monitors the Commission's performance in output delivery.
- The Commission reports to Parliament annually and to the Ministry of Economic Development by way of confidential quarterly reports, in terms of its overall financial performance and capability, and against four appropriations.
- The Commission also provides confidential extracts of its quarterly reports to the Ministers of Agriculture and Forestry and Consumer Affairs, as Ministers with responsibilities in the dairy sector and fair trading area respectively.
- The key Act for the Commission is the Crown Entities Act 2004 which, following Royal Assent, will come into force on 25 January 2005. A significant focus for the Commission will be the new reporting provisions, more specifically the presentation of a Statement of Intent which will apply from the 2006/2007 financial year. This statement of intended performance will be the centrepiece of the accountability relationship between the Commission and Ministers.

- The Commission does not advise the Government on policy matters. It performs its enforcement and regulatory control functions within the relevant statutory frameworks.
- The Commission currently comprises six Members that include Paula Rebstock (Chair), David Caygill (Deputy Chair), Douglas Webb (Telecommunications Commissioner) and Denese Bates QC, Donal Curtin and Peter Taylor (Commissioners). In addition, Shaan Stevens and Roy Hemmingway are Associate Members of the Commission and Fiona Bolwell and Terence Stapleton are Cease and Desist Commissioners.
- The Commission has offices in Wellington, Christchurch and Auckland and has 130 staff. Its 2004/2005 budget is \$19.3 million (GST inclusive).
- In addition to its operating budget, the Commission has access to an ‘Other Expenses’ appropriation of \$1.688 million (GST not applicable) for major litigation cases. 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.
- The Commission, in conjunction with MED, Treasury, and other appropriate parties, have recently completed reviews of both the Commission’s baseline and vote structure. The Commission is currently preparing a baseline bid to be implemented in the 2005/2006 financial year. In addition, the Commission is participating in reviews of its Litigation Fund and of the fee structure and levels for authorisations and clearances under the Commerce Act.
- The Commission has identified four key internal management and infrastructure projects to be undertaken this financial year. Those projects relate to strategic planning, review of policies and procedures, review of expenditure and resourcing requirements and an update to the Commission’s website to improve functionality and accessibility.
- Enforcement activity occurs under the Commerce, Fair Trading and DIR Acts. The Commission recently received enforcement responsibility under the CCCF Act.
- The Commission intends to increase its enforcement impact under the Commerce and Fair Trading Acts. Resources have previously been diverted away from these areas due to an increase in adjudication cases.
- The Commission’s adjudication functions are under the Commerce, Dairy and Telecommunications Acts. The Commission determines applications for merger and acquisition clearances, authorisations of anti-competitive market behaviour and acquisitions, and determines applications for access to Telecommunications networks, or applications for determinations concerning the entry and exit of shareholding farmers to or from Fonterra.
- The Commission has powers under the Commerce Act to require individuals and businesses to provide information, and may require them to appear before the Commission to answer questions. The Commission also has a variety of search and

seizure powers under relevant legislation ranging from routine inspection powers to the ability to obtain and execute search warrants.

- The Commission has recently received four applications for leniency to assist its investigations into anti-competitive behaviour under the Commerce Act. The Commission is focused on completing a number of long standing Commerce Act investigations.
- In November 2004, the Commission delivered its regulatory control inquiry into the supply of gas pipeline (transmission and distribution) services to the Minister of Energy. The Commission recommended direct control under Part V of the Commerce Act should be imposed on gas distribution companies Powerco Limited and Vector Limited.
- The Commission assumes responsibility for enforcing the major provisions of the CCCF Act on 1 April 2005. The part of the Act which relates to buy-back transactions was enacted on 14 October 2003 and is already being enforced by the Commission.
- Fair Trading priority areas for 2004/2005 include motor vehicles, financial services, new immigrant businesses, cross-border breaches, misleading price representations and food and dietary-related claims.
- In the telecommunications sector, the Commission is presently:
 - monitoring Telecom’s progress in reaching two broadband targets;
 - determining the net cost of Telecom’s telecommunication service obligations for the 2002/03 financial year;
 - considering an application from TelstraClear for access to the wholesale bitstream services which was regulated following the Commission’s unbundling report; and
 - progressing separate investigations into number portability and mobile termination.
- In the electricity sector, the Commission is presently:
 - reviewing the Electricity Information Disclosure Requirements 2004;
 - working with the Electricity Commission on the transfer of the Commission’s jurisdiction under Part 4A regarding Transpower; and
 - finalising the *Assessment and Inquiry Guidelines* as part of the targeted control regime.
- In the dairy sector, the Commission is:
 - preparing evidence in respect of two proceedings currently before the courts under the DIR Act, relating to the discount rate and the meaning of ‘retention’; and
 - investigating an application for a determination from the Open Country Cheese Company relating to reasonable transport costs.

Introduction

The purpose of this briefing document is to provide incoming Ministers with an introduction to the Commerce Commission, including:

- summary information on the Commission's role, function, structure (see Appendix 1), accountability and information-gathering powers;
- an overview of the environment in which the Commission operates, including major issues and issues affecting the overall capability of the Commission; and information on the Commission's operational activities.

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 general thrust of each piece of legislation to arrive at its overall purpose.

Strategic Planning

In response to a changed environment and its increase in responsibilities, the Commission completed a review of its Strategic Plan in May 2004, including its purpose, values and strategic goals. The new purpose statement reflects the Commission's view of its various statutory responsibilities:

The Commission has identified two strategic priorities.

▪ **Impact**

The Commission will focus on maximising the effectiveness of its enforcement activity in relation to anti-competitive behaviour and false and misleading behaviour.

▪ **Capability**

The Commission will:

- ensure that it is able to attract the best people and retain them for longer;
- invest in its people to allow them to develop to their full potential to best meet both their needs and the needs of the organisation;
- maintain a healthy work environment; and
 - ensure excellence and best practice across the organisation.

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, EIR, Telecommunications, DIR and CCCF 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 solicitor. These Commissioners are appointed for the sole purpose of hearing and determining applications for cease and desist orders.

The Commission currently comprises six Members that include Paula Rebstock (Chair), David Caygill (Deputy Chair), Douglas Webb (Telecommunications Commissioner) and Denese Bates QC, Donal Curtin and Peter Taylor (Commissioners). In addition, Shaan Stevens and Roy Hemmingway 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:

- 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): and
- Regulatory Control Inquiry: Gas Pipeline Services (Vote Energy).

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, respectively.

The Commission prepares an Annual Report, including audited financial statements, that is tabled in the House of Representatives. The Commission also publishes an Annual Plan that sets out the intended activities for the year in some detail.

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'.¹

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 and dairy 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."*

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

Public Finance (State Sector Management) Bill

The House passed the Public Finance (State Sector Management) Bill on 16 December 2004. The key initiative is to support better integration, greater flexibility and an increased focus on results, while at the same time retaining current strengths of transparency, accountability and financial management.

The key Act for the Commission is the Crown Entities Act 2004 which, following Royal Assent, will come into force on 25 January 2005. A significant focus for the Commission will be the new reporting provisions, more specifically the presentation of a Statement of Intent which will apply from the 2006/2007 financial year. This statement of intended

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

performance will be the centrepiece of the accountability relationship between the Commission and Ministers.

Trans-Tasman Harmonisation

The New Zealand and Australian Governments have confirmed their desire for closer harmonisation of competition law and policy. The Commission can see significant benefits in the harmonisation of competition and consumer policies with Australia. The Commission is currently awaiting the final report of the Australian Productivity Commission which is undertaking a study to identify opportunities for closer harmonisation. In addition, Commission Chair Paula Rebstock is leading a team of industry and government representatives in trying to achieve this.

In the meantime, the Commission has further developed its relationship with the ACCC in the preparation of 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 ourselves.

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. Cartels involve secretive conduct such as collusive behaviour involving price fixing and merchant sharing. These arrangements are very difficult to detect. Other overseas agencies have found that providing incentives to cartel members to break the cartel is critical to enforcement.

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. It is important that it is made clear that immunity is only available to the first party to approach the Commission, creating the necessary incentives and uncertainty for the parties in the cartel. The Leniency Policy aligns the Commission with competition agencies worldwide, most of whom offer comparable policies.

The Commission has received four recent applications for leniency.

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, 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 the broader range of outputs. The challenge for the Commission is to achieve market driven solutions that in turn deliver increased market effectiveness.

An investment in both operational and corporate capabilities saw the Commission launch its Strategic Plan for 2004-2007. The Plan was a catalyst for the Commission to refocus on all areas of its role and responsibilities. This strategic review included extensive consultation with key external stakeholders such as Ministers, Government officials, businesses, consumers and representative organisations.

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, the content of investigations and an increase in external expectations.

The Commission's focus in 2004/2005 has and continues to be on the implementation of the regulatory regimes in the electricity, telecommunications and dairy industries that have been developed over the last few years and on improving its effectiveness under the Commerce and Fair Trading Acts.

In respect to the Commerce Act, the Commission continues to improve its effectiveness with particular focus on cases under s 36. In addition, the Commission is encouraging increased use of its new Leniency Policy by members of cartels.

The Commission assumes responsibility for enforcing the major provisions of the CCCF Act on 1 April 2005. The primary focus during 2004/2005 is on informing businesses of their obligations under the Act and promoting early compliance. Inspection and investigation activity will begin post 1 April 2005. The sections of the Act relating to 'buy-backs' have been in force since 14 October 2003 and are already being enforced by the Commission.

The first six months of 2004/2005 have seen the Commission, in conjunction with MED, Treasury, and other appropriate parties, participate in four separate reviews of the Commission's funding arrangements.

Two of these reviews were recently completed. The first was a baseline review of the Commission's activities under Vote Commerce (Enforcement of General Market Regulation). The Commission has received supplementary funding for this appropriation in both financial years 2003/2004 and 2004/2005, and is currently preparing a bid for additional funding consistent with the completed review, to take effect from 2005/2006.

The second review was an evaluation of the accountability and purchasing arrangements of the Commission to assess whether the current multiple vote structure is the appropriate structure.

A review of the Litigation Fund – in particular, recommendations on the appropriate mechanism for the funding of litigation expenses as well as ensuring the level of funding is appropriate, and a review of the fee structure and levels for authorisations and clearances under the Commerce Act are continuing.

Resourcing for 2004/2005 and Beyond

The Commission has offices in Wellington, Christchurch and Auckland and has 130 staff. The Commission's operating budget is \$19.3 million (GST inclusive), 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.

Vote	Appropriation	2004/05 \$m (GST incl)	2003/04 \$m (GST incl)	2002/03 \$m (GST incl)
Commerce	Enforcement of General Market Regulation	10.880	10.116	8.880
	Enforcement of Dairy Sector Regulation	1.018	1.408	1.430
Communications	Enforcement of Telecommunications Sector Regulation	3.938	3.938	3.938
Energy	Enforcement of Electricity Sector Regulation	3.000	3.000	3.000
	Regulatory Control Inquiry – Gas Pipeline Services	0.450	1.519	0.281
TOTAL		19.286	19.981	17.529

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 \$1.688m (GST not applicable), 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.

As outlined earlier, the Commission has undergone significant growth, both due to its new responsibilities and the increasing complexity of the markets within the General Market area. In addition, the Commission has seen an increase in high cost, complex authorisation applications such as those by Air New Zealand and Qantas and the Pohokura Gas Authorisation. This increased complexity and cost has diverted resources away from its enforcement activity under the Commerce and Fair Trading Acts. In order to lift the volume and quantity of its enforcement activity, the Commission received supplementary funding in 2003/2004 and 2004/2005.

While this supplementary funding will reduce the impact of adjudication activity, it will not address an underlying structural deficit.

Key Departmental Relationships

The Commission has a number of key relationships with Ministries and Departments.

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 to support consumer protection and a primary role in directly supporting consumers to 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, the Taiwan Fair Trade Commission and Her Majesty's Secretary of State for Trade and Industry and the Office of Fair Trading (OFT) in the United Kingdom. The objectives of the arrangements are to promote co-operation and co-ordination in relation to the application of the competition and consumer laws each agency enforces. The agencies also 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.

GENERAL MARKET REGULATION

Commerce

The Commerce Act is a set of generic competition laws that prohibit anti-competitive market behaviour and 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, sets 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. Some of the provisions in the EIR Act are being revised in light of the recent legislative changes relating to the electricity industry.

The Commission carries out enforcement and regulatory control activities, primarily focussing on 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 deter other businesses from breaching the Act.

Enforcement

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

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

Market behaviour investigations

In the previous financial year, the Commission commenced 44 investigations into alleged anti-competitive behaviour and resolved 38 investigations. Twenty six investigations were resolved with no further enforcement action required by the Commission, while six were closed with the Commission issuing warnings to the businesses concerned.

The Commission closed one investigation with the decision to take civil action.

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). Through CDP, Telecom offers other telecommunications service providers its retail end-to-end high-speed data transmission services for re-sale; and
2. access to dedicated data tails in Telecom’s network in order to supplement the other telecommunications service providers’ own network 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.

Ophthalmology

In March 2004, the High Court found the Ophthalmological Society of New Zealand Inc and five ophthalmologists contravened the anti-competitive provisions of the Commerce Act. The Court found that the ophthalmologists and the Society entered into arrangements in 1996 to block entry by Australian ophthalmologists from carrying out routine cataract surgery in Southland in 1997.

In the penalty hearing in June 2004, the High Court ordered penalties of \$100,000 against the Society, and a total of \$30,000 against the two doctors most involved in the

arrangement. The Court also ordered that the defendants pay more than \$460,000 costs to the Commission.

This decision was initially appealed by the Society and the five surgeons. This appeal was withdrawn mid December and the matter is now concluded.

Carter Holt Harvey

The Privy Council heard an appeal brought by Carter Holt Harvey Building Products Group Limited in the Pink Batts case. The Privy Council delivered its judgment in July 2004, finding that Carter Holt Harvey had not abused its market power and reversing a unanimous Court of Appeal judgment.

The Commission had alleged that Carter Holt Harvey had priced below cost to eliminate competition from a South Island company that produced an innovative woollen insulation product in competition with Carter Holt Harvey's Pink Batts product. The Privy Council considered that low prices were the outcome of competition. It considered that the case raised an important and fundamental issue of principle about the extent to which competition law should inhibit competitive conduct through price-cutting by dominant firms.

The Commission is considering the impact of this decision on the operation of s 36 of the Commerce Act and its implications for the promotion of competitive behaviour. The Commission will continue to focus on bringing proceedings under s 36 to further develop precedent and guidance for businesses and for the Commission in this complex area.

Market structure investigations

In the previous financial year, the Commission commenced 17 market structure investigations and resolved nine investigations. Those resolved investigations focused on business transactions that have not been, or are not intending to be, notified for clearance or authorisation. In several of these cases, parties were encouraged to seek clearance, while the majority required no further enforcement action.

Investigation or enforcement activity remains quite constant, although in the last year due to the resources required for our adjudication activity, the Commission has not opened as many investigations as normal. However, the Commission considers that it has identified and reviewed all key acquisitions that should be considered and the Commission continues to consider around 20 acquisitions a year that have not come through the clearance or authorisation process.

In addition to formal enforcement action, the Commission maintains a monitoring and surveillance programme where merger and acquisition activity is identified and assessed against high level criteria, primarily the safe harbours as well as giving consideration to the Commission's enforcement 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 legislation. The Commission will grant an authorisation if it finds that the benefits of the acquisition or arrangement outweigh the detriments. The Commission also considers applications for exemption from certain requirements of the EIR Act.

The Commission has maintained a fairly consistent level of clearance activity post the change to the competition threshold from dominance to substantial lessening of competition (SLC) in May 2001.

The Commission handles approximately 25-30 clearances a year. On average 2-3 of these are declined each year. The Commission has noticed an increased complexity in terms of the cases that are now coming to the Commission. This complexity is both in the application of the SLC test and in the nature of the acquisitions in question where there has been an increase in global or multinational mergers, and also in small specialist industries where aggregation can be very high.

The Commission received its first case law on its approach to assessing mergers and acquisitions using the SLC test, in the form of the recent High Court judgement on the Brambles/GE Capital Returnable Packaging Systems. While the Court overturned the actual decision, it generally accepted the Commission's approach to applying the SLC test. The Commission has reviewed its Mergers and Acquisitions Guidelines to reflect the Court's comments.

The Commission recently considered several complex and high profile applications for authorisations, namely the Air New Zealand Limited and Qantas Airways Limited authorisation applications. In September 2004, the High Court dismissed the appeal by Qantas and Air New Zealand of the Commission's decision to decline authorisation for the airlines to enter and give effect to potentially anti-competitive alliance arrangements, and for Qantas to acquire 22.5 percent of the voting equity in Air New Zealand.

The Commission granted authorisation to OMV New Zealand Limited, Shell Exploration New Zealand Limited and Shell (Petroleum Mining) Company Limited and Todd (Petroleum Mining Company) Limited in September 2003. Subject to conditions, the Commission's authorisation provided for the parties to discuss and agree on all relevant terms and conditions, including price, quantity, rate, specification and liability for the joint sale of gas from the Pohokura natural gas field. The authorisation also provided for the parties to negotiate and enter into contracts for the sale of gas from the field jointly, for example as one seller.

Shell and OMV informed the Commission in April 2004 that the parties had decided to market gas from the Pohokura field separately. The Commission believes that on the face of it, this represents a material change in the circumstances around which the Commission determined to authorise the proposed anti-competitive arrangement, and the

Commission is considering a possible revocation of its decision on the basis that a material change in circumstances may have occurred since the authorisation was granted.

The Commission will release a draft report in 2005.

Regulatory Control

The Commerce Act envisages the possibility that control may be introduced over goods and services where competition is lessened and the imposition of control would be in the interests of acquirers. The Commission can initiate its own study into whether control should be imposed or alternatively, a study could be requested by the Minister.

In May 2003, the Commission commenced work on an Inquiry into the supply of gas pipeline (transmission and distribution) services, at the request of the Minister of Energy. The Commission completed its Inquiry and reported to the Minister on 29 November 2004.

The Commission recommended that direct control under Part V of the Commerce Act should be imposed on gas distribution companies Vector Limited and Powerco Limited. The Commission did not recommend direct control for NGC Transmission Limited, NGC Distribution Limited, Wanganui Gas Limited, Maui Development Limited, Nova Gas Limited and the individual transmission pipelines located in the Taranaki area.

The Commission's inquiry found that Vector and Powerco each have substantial market power and are earning excess returns above their cost of capital to an extent that the Commission is satisfied that it should recommend direct control.

The final report noted that the Minister has a wider discretion than the Commission to consider other matters including alternatives to control under Part V. The Commission's view is that a targeted control regime has the potential to offer a more favourable trade-off between costs and benefits of regulatory intervention than a regime under the Part V control provisions of the Act, based on the Commission's experience with electricity lines businesses.

The Minister has indicated a decision on the Commission's recommendations will be made mid-2005.

Fair Trading

The Commission carries out enforcement activities under the Fair Trading Act and the Credit Contracts and Consumer Finance Act.

Fair Trading Act

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.

Priority areas for 2004/2005 include motor vehicles, financial services, immigrant businesses, cross-border breaches, misleading price representations and health and dietary-related claims.

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 information about used motor vehicles in order to make informed purchasing decisions and offers a level of protection in terms of the accuracy of the information being provided. Displaying such information in a consistent manner also gives consumers the ability to make accurate comparisons between vehicles, and thus make more informed decisions on which vehicle they buy.

Fair Trading Amendment Act (No 3)

Changes to the Fair Trading Act in July 2003 extended the Commission's powers to deal with misleading and unfair trading practices by businesses.

The amendments double the maximum penalties for offences from \$30,000 to \$60,000 for individuals and \$100,000 to \$200,000 for companies.

The provisions relating to new information gathering powers means the Commission can now, by serving a notice, require businesses to provide information and documents

relating to an investigation. Persons who are required to supply information or documents to the Commission have the same privileges as witnesses have in court. This means that a person could refuse to comply with a notice if to do so would incriminate him or her. In addition, extension of the search warrant powers means the Commission is able to use a search warrant to find out the extent of offending, such as the amount of money made from the activity. It will no longer be limited to simply finding information to establish an offence.

Pyramid schemes are hit the hardest by the amendments, with the maximum penalty of \$200,000 available for both companies *and* individuals, and the court being able to order payment of the equivalent revenue or 'commercial gain' earned from the offending.

Amendments included:

- increases maximum penalties for all offences:
 - \$60,000 for an individual;
 - \$200,000 for companies;
- in the case of pyramid selling schemes, the maximum penalty is the higher of:
 - \$200,000 for both individuals and companies; or
 - the value of any commercial gain derived from the scheme;
- amends the definition of pyramid selling schemes;
- extends the limitation period for criminal offences;
- removes the requirement to provide undertakings as to damages for interim injunctions;
- provides jurisdiction to the District Court to order corrective advertising;
- extends search powers to include ability to obtain information as to the extent of the offending; and
- provides new information gathering powers (similar to s 98(a) and (b) of the Commerce Act).

GM-free Labelling Guidelines

The Commission has been involved in a number of discussions on GM-free labelling resulting from the Royal Commission on Genetic Modification. The Commission is working with the ACCC in developing a joint Australasian guideline for industry. As part of achieving this, the Commission released a discussion paper in June 2004, and received in excess of 75 submissions. The Commission is now about to enter into discussions with the ACCC, informed by the submissions received.

Immigrant Business Strategy

Over the last two decades, New Zealand's population has undergone a number of changes, particularly in relation to immigration from Asian countries. The growth in

immigrant communities has created a number of challenges for the Commission, as it has for other government agencies and regulatory bodies.

These challenges include:

- 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 currently implementing strategies for ensuring compliance with the Fair Trading and CCCF Acts amongst immigrant communities and businesses in New Zealand. The thrust of the strategy is based upon the provision of information supported by enforcement activity. The Commission is also developing strong contacts within key groups, such as the Chinese Chamber of Commerce recently established in Auckland.

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 counterparts and other international counterparts (through membership of the International Consumer Protection and Enforcement Network) to more effectively prevent and take action against these traders. This includes sharing of information about current scams, traders of concern, current and past enforcement action and methods of enforcement. 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 repeals the Credit Contracts Act 1981 and the Hire Purchase Act 1971, and provides for the introduction of a new legislative framework governing credit contracts and consumer leases. The Act aims to remedy the problems experienced under former law by providing 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 come into force in April 2005, but the provisions relating to buy-back schemes were retrospective and the Commission's activities with respect to these are outlined below.

The retrospective buy-back provisions in the CCCF Act were enacted in October 2003. Since that time, the Commission has conducted an extensive study of the schemes currently operating to identify the number and type of schemes in the market, the operators of these schemes, who else is taking action against buy-back promoters and which scheme or schemes are likely to be most suitable for the Commission to pursue under the provisions in the CCCF Act.

The Commission has identified one very large scheme and has now moved into the investigative phase. The Commission's aim is to set precedent in terms of having certain buy-backs transactions declared oppressive and seeking to have traders banned from operating such businesses.

The Commission has identified that it will face considerable difficulties in achieving the aims stated above. This is primarily because affected persons are reluctant to co-operate; innocent parties have become involved in the transactions; it may be difficult to have the courts find that the buybacks are, in fact, oppressive; and it is likely to take a significant number of oppressive contracts for the courts to consider banning orders.

The Commission is in the early days of enforcing the Act and is currently working through issues with respect to the extent of the Commission's powers. The Commission will follow up with the Ministry of Consumer Affairs as issues arise, and with relevant Ministers as appropriate.

The Commission is also preparing for the introduction of the substantive provisions of the CCCF Act. Seminars for credit providers have been conducted throughout New Zealand to inform them of their obligations under the Act. The Commission is also producing a guide to the Act that will be published in the New Year. In addition, it is finalising its enforcement strategy and training both internal and external staff.

Enforcement of the CCCF Act is proving to be considerably more resource-intensive than originally anticipated and forms part of the Commission's baseline funding case.

Information

In addition to its enforcement activities, 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 prevent and 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.

In January 2005, the Commission will publish an updated version of its guide to the Fair Trading Act. This publication provides guidance on how to operate a business without breaking the law in respect of the Fair Trading Act. The guide provides information primarily to assist businesses and advertisers, and has proven to be a useful resource for consumers. It is not intended to be definitive or used in the place of legal advice.

The Commission obtains information about potential breaches of the law from both its own surveillance and inspection activity and from the public. 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 4,000-6,000 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 2003/2004 year, the Commission completed 410 general fair trading investigations and 58 standards investigations; approved 23 cases for criminal prosecution; and concluded 14 criminal prosecutions and three civil actions. It also entered into settlements with 30 businesses, issued 187 warnings and sent 135 compliance advice letters to businesses.

SECTOR SPECIFIC REGULATION

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.

Under the Telecommunications Act 2001, the Kiwi Share Obligation was updated to become the Telecommunications Service Obligations (TSO). The TSO, as set out in the 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 TSO services to commercially non-viable residential customers in compliance with the TSO Deed. The TSO services are detailed in the TSO Deed, and include basic telephone access, free local calling and low speed internet access.

A second TSO was recently introduced – the New Zealand Relay for people who are deaf, or who have speech or hearing impairments.

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 of its own volition 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

Local Loop Unbundling

In December 2003, the Commission recommended to the Minister of Communications that regulation be introduced to improve competition for broadband Internet services in the residential and small and medium-sized business markets.

The Commission recommended:

- unbundling of, and interconnection with, Telecom's fixed Public Data Network in the form of access to an asymmetric Digital Subscriber Line (DSL) bitstream access service; and
- access to a backhaul transmission service used in conjunction with an asymmetric DSL bitstream service.

The Minister adopted the Commission's recommendations, and new regulated bitstream and backhaul services were introduced in September. Two access disputes have been filed with in relation to these services. One of the two, an application by ihug, was withdrawn on 22 December, following a commercial agreement.

The Commission is also monitoring Telecom's progress to reaching two targets:

- 250,000 Telecom residential broadband customers;
- a third of those customers served via non-Telecom wholesale channels.

The Commission supplies quarterly reports on progress to MED and also publishes the uptake results.

Telecommunication Service Obligations

The Commission is required annually to identify and determine the allocation of specified telecommunications service obligation (TSO) costs relating to local residential telephone and dial-up internet service between liable telecommunications companies. The Commission is required to take into account any revenue and other benefits received by Telecom when providing this service. Liable parties are required to provide the Commission with certain information to enable it to make a determination.

In December 2003, the Commission announced its calculation of Telecom's net cost of complying with TSO for the period from 20 December 2001 to 30 June 2002. The Commission calculated the net cost at \$34.72 million for the part year period, or \$65.67 million annualised.

The Commission is finalising the process of determining the net cost to Telecom of meeting its TSO obligations for the 2002/2003 financial year, following the release of a draft determination in June 2004.

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. This includes the local end of toll calls, toll free calls and payphone calls. The Commission set the interconnection price for calls between the Telecom and TelstraClear networks at 1.13 cents per minute. The price is effective for 12 months from 5 November 2002. TelstraClear Limited and Telecom agreed to backdate the price to 1 June 2002.

Telecom and TelstraClear have 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 is currently developing a model to determine these costs. The Commission will consult with interested parties following the release of a draft report decision in early 2005.

Wholesale

In May 2003, the Commission made its final determination relating to the supply of Telecom retail services on a wholesale basis between Telecom and TelstraClear. Services covered by the Commission's determination included business line rental and local calling, fixed-to-mobile services, directory assistance, voice messaging, business and residential broadband access and data services outside the major centres.

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.

This determination largely relates to the wholesaling of business services and residential broadband. Telecom and TelstraClear have 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 have sought a review of this determination.

The Commission is currently developing its approach to implementing the pricing principles set out in the Act. The Commission will consult with interested parties prior to releasing a draft decision.

Broadband 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 Commission is currently considering submissions on the TelstraClear application, which covers a wide range of matters. The Commission will issue a draft determination in early 2005.

TelstraClear has also applied for a determination in relation to additional wholesale services which support broadband applications, in particular Telecom's Private Office service.

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 is developing codes associated with local and cellular number portability. The Commission will consider these codes when they are submitted for approval following consultation by the Forum with its members.

The Forum has sought approval for a code on the co-location of mobile network equipment. The Commission is currently reviewing the code, and will finalise the review early in 2005.

Number Portability

Five carriers 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. Those carriers were TelstraClear, Callplus Limited, Compass Communications Limited, ihug and WorldxChange Communications Limited.

The Act defines local number portability as a service that enables a user of a fixed telephone network service to change providers of that service, but to retain the same telephone number within a local calling area. Cellular telephone number portability is defined as a service that enables a user to change providers but to retain the same telephone number, including the same cellular network access code.

The Commission considered the application in conjunction with the development of codes covering operational and technical matters by the Industry Forum. The Commission issued a draft report on cost allocation in December 2004. The Commission will hold a conference on the draft early in 2005.

The Commission's view in the draft report was that:

- *Industry common set-up costs* of local and cellular number portability should be allocated amongst all providers of local and/or cellular telephone services respectively in line with market share, measured by subscriber numbers.
- *Operator specific set-up costs* should be borne by each operator, providing incentives for each operator to minimise costs while maintaining the ability and incentive to compete.
- *Per-line set-up costs* should be recoverable by a donor network operator from a recipient network operator. The donor network operator should not seek to recover any part of those costs from the out-porting customer.
- Each operator should bear its own *additional call conveyance costs*.

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.

The Commission released a draft report on mobile termination in October 2004. In the draft, the Commission concluded that:

- a reduction in mobile termination rates is likely to increase competition in the fixed-to-mobile market and result in a sustainable lowering of the retail price for fixed to mobile calls; and
- there are likely to be significant net benefits to consumers from the regulation of mobile termination rates on existing non-3G networks but not future 3G networks.

The Commission is holding an industry conference in February 2005, and will thereafter forward to the Minister its final report and recommendations as to whether or not to regulate the mobile termination service.

Electricity

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 EIR 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, which commenced on 8 August 2001, gives the Commission responsibilities for the regulation of electricity lines businesses (of which currently there are 29, including 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;
 - assessing lines businesses against those thresholds;
 - determining whether to declare regulatory control; and
 - controlling, if necessary, the prices, revenues 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.

The Commission set its initial thresholds in June 2003, and at the end of March 2004 put in place its information disclosure regime. The Commission's review of asset valuation methodologies has been integrated into its development of both the targeted control and information disclosure regimes.

Targeted control regime and development of thresholds

The purpose of the targeted control regime is to promote the efficient operation of markets directly related to electricity distribution and transmission services through targeted control for the long-term benefit of 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 generally follows the 'CPI minus X' formulation commonly used for price control in other jurisdictions. The Commission set the price path threshold, in the first instance, such that a lines business would breach the threshold if its average price as at 6 September 2003 was to exceed its average price as at 8 August 2001, when Part 4A of the Commerce Act came into effect.

To comply with the price path threshold at the second assessment date (31 March 2004), each distribution business must not have increased its average prices, net of certain costs, since the date at which it was first assessed (6 September 2003).

To comply with the quality threshold at the second assessment date, each distribution business must have demonstrated no material deterioration in reliability of supply over the previous 12 months, and that it has meaningfully engaged with consumers to determine their demand for service quality.

Under the initial thresholds set by the Commission on 6 June 2003, all lines businesses were required to provide their self-assessments against the price path threshold as at 6 September 2003. For this first assessment date the Commission completed assessments against thresholds for 29 companies. The Commission identified 13 companies had breached the thresholds. Of the 13 breaches, eight were technical in nature requiring no further action. One organisation (Transpower) was required to resubmit its compliance statement to the Commission in an alternative form and inquiries were opened in February 2004 into three others. These inquiries are ongoing as at December 2004 but are all at a critical stage where deadlines have been set for considering offers of administrative settlement prior to the Commission's determining whether to proceed to publish an intention to declare control. The Commission expects to resolve these existing inquiries in the first half of 2005.

The Commission has completed its initial review of the second self assessments of the performance of all 28 electricity distribution businesses 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 concerning the trade-offs between price and service quality, with a view to developing possible best practice criteria. Expert consultants have been engaged to assist the Commission with its review.

The Commission is required to publish the reasons for its decisions in respect of those lines businesses that have been found to have breached the price path threshold as at 6 September 2003, and for which the Commission has made a decision not to declare control.

On 1 March 2004 Electra Limited, The Lines Company Limited, Centralines Limited and Counties Power Limited issued proceedings in the Wellington High Court seeking judicial review of the Commission's decision to reset the price path thresholds under Part 4A of the Commerce Act 1986. The Plaintiffs claim that the Commission's consultation process was flawed and the Commission's decisions are unreasonable. They are therefore seeking orders to have the threshold decisions set aside and requiring the Commission to reconsider its decisions. The reset thresholds applied from 1 April 2004. The High Court hearing, at which the Commission defended its position, took place on 30 November 2004.

On 23 December 2003, the Commission released its decisions on the performance thresholds to apply to electricity lines businesses from 1 April 2004 (1 July 2004 for Transpower), under subpart 1 of Part 4A of the Commerce Act. The Commission set two thresholds, a price path threshold of the form CPI-X, and a quality threshold. These thresholds retained the same form as the initial thresholds set by the Commission on 6 June 2003, except that different businesses were assigned different X factors.

Distribution businesses will be assessed annually against the thresholds, over a regulatory period of five years beginning on 1 April 2004. Transpower's thresholds were set for a period of one year from 1 July 2004, primarily due to uncertainties regarding the approach the Electricity Commission will take with respect to Transpower's investment programme.

On 30 June the Commission published its *Commerce Act (Transpower Thresholds) Notice 2004*, setting Transpower's price path and quality thresholds for another year.

Work continued on finalising the Commission's *Assessment and Inquiry Guidelines*, which outline the Commission's broad process and analytical framework for assessing threshold compliance and for undertaking post-breach inquiries under the targeted control regime. These were issued on 19 October 2004.

Information disclosure by electricity lines businesses

In June 2003, the Commission issued limited information disclosure requirements, designed to support the assessment of lines businesses against the thresholds.

On 31 March 2004, the Commission published the *Commerce Act (Electricity Information Disclosure Requirements) Notice 2004* in the *Gazette*, and also released its

final Electricity Information Disclosure Requirements 2004 and the companion Disclosure Handbook. The Requirements and the Disclosure Handbook largely replicate the existing disclosure regime outlined in the *Electricity (Information Disclosure) Regulations 1999* administered by the Ministry of Economic Development. The Regulations were revoked on 6 April. The Commission indicated that it would undertake a full consultative review of the information disclosure regime under Part 4A during the 2004/05 financial year.

The finalised ODV Handbook, which prescribes the methodology for valuing the system fixed assets of electricity lines businesses and forms part of the disclosure requirements, was issued on 30 August 2004 and came into effect on 31 August 2004. The Commission also issued a Companion Report to the Handbook that addressed key issues raised by interested parties during consultation on its development.

The ODV Handbook facilitates consistent comparisons of lines business asset valuations, as well as of financial performance measures based on those valuations. All lines businesses will be required to use the new ODV Handbook in complying with the information disclosure requirements for the disclosure year ending in 2004. Asset valuations prepared using the Handbook will also be relevant to the targeted control regime.

On 24 December 2004 the Commission issued its *Discussion Paper on Information Disclosure for Electricity Lines Businesses*. This is the first step in its planned review of the Electricity Information Disclosure Requirements 2004. At the same time the Commission issued its paper: *Implementing Valuation Choice for System Fixed Assets: Draft Decisions and Discussion Paper*. This introduces the choice between Indexed Historic Cost and Optimised Deprival Value valuations for use in information disclosure, post-breach inquiries, control declarations, and (potentially) threshold resets.

Electricity Commission

The Commerce Amendment Act (No 2) 2004 came into force on 18 October 2004 and provides for the possible transfer of the Commission's jurisdiction under Part 4A regarding Transpower to the Electricity Commission at any time and regarding the distribution businesses after the end of the current regulatory period (1 April 2009). In the current regulatory period, both Commissions will need to work closely together to ensure that the broad approach to regulating electricity lines businesses is consistent, as there are some potential areas of overlap in the functions of the two Commissions, for instance in the information disclosure requirements issued by the two bodies.

In addition, while there is no overlap in responsibilities as such, an interface between the two Commissions exists with respect to Transpower. It is possible that decisions made the Electricity Commission could affect the reasonable costs incurred by Transpower, which the Commission would then need to take into account when setting and/or monitoring compliance with the thresholds. This is why the Commission has reset Transpower's thresholds for one year only.

The Commission and the Electricity Commission will work closely together to ensure that there is a high degree of co-operation and consultation. The Commission considers that this can be achieved through:

- the Memorandum of Understanding between the two Commissions, which is currently being finalised;
- cross appointment(s) across the Commissions, with Roy Hemmingway having been appointed as an Associate Commissioner to the Commission; and
- the sharing of information between the Commissions.

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

The Commission is preparing evidence in respect of two proceedings currently before the courts under the DIR Act.

The first relates to Fonterra's judicial review of the Commission's decision setting the discount rate for calculating Fonterra's annualised share value for the 2001/2002 season.

The second relates to Fonterra's application to the High Court for a declaration that 'new co-op retention' as defined in regulation 8(6) of the Dairy Industry Restructuring (Raw Milk) Regulations 2001 (the Raw Milk Regulations) does not include the amount of Fonterra's after-tax loss (if any).

The proceedings were filed in the Auckland and Wellington High Courts respectively. The Commission has an application before the court to consolidate the two proceedings in Wellington.

Discount Rate

In June 2003, the Commission set the discount rate for calculating Fonterra's annualised share value for the 2001/2002 season.

Regulation 8(1) of the Raw Milk Regulations enables an independent processor, in certain circumstances, to require Fonterra to supply raw milk at the 'default milk price' set by the Raw Milk Regulations. The discount rate is used in calculating the annualised

share value which is a component in the calculation of the default milk price paid by independent processors.

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 did not use a cost of capital rate in calculating the price of a co-operative share for the 2001/2002 season. The share price for the 2001/2002 season was \$3.00 per share and was agreed as part of the Merger Proposal for the merger of New Zealand Co-operative Dairy Company Limited and Kiwi Co-operative Dairies Limited.

The Commission set the discount rate at 11.7 percent. This rate compares with the discount rate proposed by Fonterra of 8.25 percent. Five methodological differences explain almost all of the difference between the Commission and Fonterra's calculations of the cost of capital in determining the discount price, with the key difference being the Commission's adoption of a cost of equity capital rather than a weighted average cost of capital as proposed by Fonterra. The Commission also adopted different personal tax assumptions compared with Fonterra.

Fonterra has challenged the Commission's decision, and in February 2004, filed for judicial review in the Wellington High Court.

Meaning of Retention: High Court Declaration

On 23 December 2003, Fonterra applied to the Auckland High Court 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 (if any).

Retention is a component of the formula used to calculate the default price of milk. 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.

This approach was questioned by the Commission and Fonterra has applied to the High Court for an interpretation of the term 'new co-op retention'.

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.

The Commission expects to release its draft determination in January 2005.

APPENDIX 1

Structure of the Commerce Commission

<p>Chair Paula Rebstock</p> <p>Deputy Chair David Caygill</p> <p>Telecommunications Commissioner Douglas Webb</p> <p>Commissioners Denese Bates QC Peter JM Taylor Donal Curtin</p> <p>Associate Commissioner Shaan Stevens Roy Hemmingway</p> <p>Cease and Desist Commissioners Fiona Bolwell Terence Stapleton</p>
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<p>General Manager Geoff Thorn</p>

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

Communications
Finance
Human Resources
Information
Technology

National office
Auckland
Christchurch
Wellington

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 was formerly the General Manager Policy at the Department of Labour, an Economic Advisor in the Department of the Prime Minister and Cabinet, and an Economic Analyst at The Treasury. Paula was a Director of the Foundation for Research, Science and Technology and is the Chair of Local Media Group Limited. She is also 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 and the Electricity Governance Establishment Group. 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 Infratil and Chair of the Accident Compensation Corporation.

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 overseas 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 Isaac Construction Limited; Port Marlborough New Zealand Limited; 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, of which he is a graduate, 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 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.

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.