

COMMERCE COMMISSION

BRIEFING FOR INCOMING MINISTERS

November 2008

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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THE COMMERCE COMMISSION

Purpose and outcomes

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 statement represents the Commission's view of its various statutory responsibilities. Each statute has its own purpose statement. The Commission has interpreted the underlying thrust of each piece of legislation to arrive at its overall purpose. It reflects the outcomes expected when markets are working effectively.

- The Commission's activities are targeted to achieve three key outcomes: competitive markets, informed consumers, and sound regulation.
- The Commission promotes competitive markets by regulating mergers and acquisitions granting clearance to market structure arrangements that do not substantially lessen competition; taking action against anti-competitive arrangements; and investigating possible unlawful use of market power. It can authorise anti-competitive arrangements if the benefits to New Zealanders would be likely to outweigh the harm.
- Effective dynamic markets depend on well-informed consumers. To foster informed consumers the Commission provides information to businesses and the public, through media coverage of enforcement action and issues, publications and guidelines, its website and seminars. The Commission also ensures consumers receive accurate and legally required information under consumer credit contracts, and enforces product safety standards.
- The Commission works to achieve sound regulation in the telecommunications, electricity distribution, gas distribution and dairy industries. This work will now also be extended to the major international airports of Auckland, Wellington and Christchurch following the Commerce Act amendments.
 - In telecommunications regulation the Commission promotes competitive outcomes by determining access to networks, limiting the exercise of market power, and calculating and allocating the cost of Telecommunication Service Obligations.
 - In airports regulation, the Commission assumes responsibility for an information disclosure regime for New Zealand's major international airports (Auckland, Wellington and Christchurch) that covers specific airport services. Information disclosure regimes aim to promote transparency and when designed well provide incentives for efficient

pricing and quality of service that may minimise the necessity for heavier handed forms of regulation.

- In electricity regulation the Commission promotes outcomes similar to workable competition through a targeted control regime that is price and quality performance based, supported by complementary information disclosure. Following recent amendments to the Commerce Act small, qualifying consumer-owned distribution businesses will be exempt from price-quality regulation.¹ The remaining distribution businesses will transit to a new default/customised control regime from 2010. The Commission also promotes transparency through an information disclosure regime for all electricity lines businesses.
- In gas regulation the Commission administers direct control of the price and quality of Vector (Auckland) and Powerco's gas distribution services, pursuant to the Commerce (Control of Natural Gas Services) Order 2005 that remains in effect until July 2012. The Commission assumes responsibility for administering a default/customised control regime for gas pipelines businesses that is price and quality performance based and a complementary information disclosure regime.
- In dairy regulation the Commission encourages competition by ensuring compliance with the Dairy Industry Restructuring Act (DIRA) and makes determinations to resolve disputes involving independent processors' access to raw milk or allegations that Fonterra is breaching the conditions for the entry and exit of potential and existing farmer shareholders.

Relevant Legislation

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

The Commission operates under a number of general and specific regulatory regimes set out in the: Commerce Act 1986, Fair Trading Act 1986, Electricity Industry Reform Act 1998, Telecommunications Act 2001, Dairy Industry Restructuring Act 2001 and Credit Contracts and Consumer Finance Act 2003.

¹ S 54D sets out the definition of consumer-owned suppliers for the purpose of exemption from the full control regime (subject to information disclosure only). (a) all control rights and equity return rights in the supplier are held by 1 or more customer trusts, community trusts, or customer co-operatives; and (b) the trustees of each customer trust or community trust, or the directors of each customer co-operative, as the case may be, that is referred to in paragraph (a) are elected solely by the persons who are consumers of the supplier, and at least 90% of the persons who are consumers of the supplier at the time of the election are eligible to vote in those elections; and (c) at least 90% of the persons who are consumers of the supplier as at an income distribution resolution date benefit from that income distribution; and (d) the supplier has fewer than 150,000 ICPs.

Commerce Act (Vote Commerce)

- The Commerce Act prohibits anti-competitive arrangements and misuse of market power. The Commission is empowered to authorise anti-competitive arrangements if there is public benefit in the arrangement. The Commerce Act prohibits mergers and acquisitions that lessen competition and the Commission may allow mergers that do not substantially lessen competition or authorise mergers again if there is public benefit in the transaction. Part 4 of the Commerce Act sets out a regulatory regime to allow for regulatory control in markets where there is little or no competition; regulation for electricity lines businesses, gas distribution and airports.

Fair Trading Act (Vote Commerce)

- The purpose of the Fair Trading Act is to encourage competition and protect consumers from misleading and deceptive conduct and unfair trading practices.
- As Fair Trading Act breaches become more sophisticated and complex, and where they have widespread public detriment, the Commission is taking an industry-wide approach to the resolution of issues.
- Fair Trading priority areas for 2008/2009 include: health, nutrition and environmental claims; financial products in particular retirement products and services; telecommunications products; bait advertising; and product safety standards.

Credit Contracts and Consumer Finance Act (Vote Commerce)

- The Act seeks to protect the interests of consumers who obtain credit, ensure they have accurate information, and provide for contracts to be varied on the grounds of unforeseen hardship.

The Commission assumed responsibility for enforcing the Act in April 2005. Priority areas for enforcement are: the charging of unreasonable credit fees; compliance with disclosure requirements; taking litigation to clarify the law, especially around reasonableness of fees.

Telecommunications Act (Vote Communications)

- The Act's purpose is to promote competition in telecommunications markets for the long term benefit of end users.
- Significant changes were made to the Act in 2006 which allow the Commission to play a more strategic role through use of a wider regulatory toolkit.

Electricity Industry Reform Act (Vote Commerce)

- The Act's purpose is to ensure that electricity prices are subject to downward pressure and that efficiencies are passed on to all classes of consumers. This is achieved by separating electricity distribution from generation and retail activities so that distribution companies are unable to leverage their natural monopoly power into either the electricity generation or retail markets.

- The Commission has enforcement and adjudication powers under the Act and is able to exempt parties from the application of the Act.

Dairy Industry Restructuring Act (DIRA)

- This Act, which authorised the creation of Fonterra, provides for a legislative package of measures to mitigate the risks of Fonterra's market power. Amongst other things, it facilitates contestability in the New Zealand raw milk market.
- The Commission's role is to ensure compliance with the Act and make determinations to resolve disputes with Fonterra involving independent processors' access to raw milk or allegations that Fonterra is breaching the conditions for the entry and exit of potential and existing farmer shareholders.

Airports (Vote Commerce)

- The Amendment Act brings the administration of an information disclosure regime for specific airport services for Auckland, Christchurch and Wellington International Airports under the scope of the Commerce Act.
- The Commission is required to make a determination setting out information disclosure requirements by 1 July 2010.

Electricity Lines Businesses (Vote Energy)

- Under the Commerce Act the Commission administers an information disclosure regime for electricity lines businesses. A full review of this was recently undertaken, and a substantially revised set of requirements was released at the end of October 2008.
- The Commission currently administers a targeted control regime for electricity lines businesses under Part 4A of the Commerce Act. The Commission has set price path and quality thresholds for reviewing the performance of electricity lines businesses. Since economic regulation was introduced, around two-thirds of distribution businesses have reduced their prices in real terms.
- Under the Part 4A thresholds regime the Commission has entered into an administrative settlements with Unison, Vector and Transpower for breaches of the price and quality thresholds. In Transpower's case, the settlement resulted in three new thresholds covering revenue requirements, quality and operating system requirements for a regulatory period ending 30 June 2011 and achieved estimated average savings over the regulatory period of \$240 million for consumers. Under the recently amended Commerce Act, the Commission will conduct an inquiry into the appropriate form of regulatory instrument for Transpower prior to the end of the regulatory period to enable a new regulatory instrument to be in place from 1 July 2011.
- From 2010, as a result of amendments to the Commerce Act, the Commission will administer default/customised price-quality regulation that will apply to non-qualifying consumer-owned and other distribution businesses only, replacing the Part

4A thresholds regime.² Information Disclosure will apply to all electricity lines businesses and along with default/customised price-quality regulation provides a complementary regime for the regulation of electricity distribution. Information disclosure will also apply to Transpower as a complementary regime supporting the administrative settlement and will likely support any recommended form of regulation to take effect from 1 July 2011.

Gas Pipelines Industry (Vote Energy)

- Under the Commerce Act and pursuant to the Commerce (Control of Natural Gas Services) Order 2005 the Commission administers direct control of the price and quality of the gas distribution pipeline services for Powerco and Vector Limited's Auckland gas distribution pipeline services. The Commission has completed a process to deliver a Final Authorisation and has declined to accept Undertakings on the control of these gas distribution services. The Final Authorisation was determined on 31 October 2008 and takes effect from 1 January 2009. The regulatory period extends through to 30 June 2012.
- The Commerce Amendment Act also requires the Commission to administer a default/customised control regime for gas pipeline businesses that is price and quality performance based, by 2012.
- The Amendment Act also brings the administration of a complementary information disclosure regime for gas pipeline businesses under the Commerce Act. This was formerly administered by the Ministry for Economic Development pursuant to regulation and will be put into place as soon as practicable after the applicable input methodology determination scheduled for 30 June 2010.

² See footnote 1, p.5 for the definition of qualifying consumer-owned distribution businesses. Consumer-owned businesses not meeting the criteria set out in s.54D will be subject to price-quality default control. Non-consumer owned businesses will similarly, regardless of size, be subject to default/customised price-quality regulation.

Membership

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 responsibilities. 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 Telecommunications Commissioner is a member of the Commission. Under the Telecommunications Act 2001, the Commissioner carries out some functions alone unless he or she requests otherwise. For example, an initial price determination for a regulated service can be made by the Commissioner. However, the Telecommunications Commissioner can request the Chair of the Commission to make two other Commission members available to perform these functions, and this has generally been the practice of the Commissioner for major decisions. There are also certain functions that can only be performed by the Commissioner with two other members of the Commission - multi-network determinations (for example, number portability), TSO decisions, and decisions on the price of regulated services, where a review is sought of the original Commission decision. Finally, where the Commissioner makes a recommendation to the Minister of Communications on the scope of regulation, the report must include the views of 2 other members of the Commission.

If there is no Telecommunications Commissioner or if the Commissioner is for any reason unable to perform the functions of the Commission, those functions must be performed by the Chair of the Commission.

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

The Commission currently comprises five members: Paula Rebstock (Chair), Donal Curtin (Deputy Chair), Dr Ross Patterson (Telecommunications Commissioner), Denese Bates QC, and Peter Taylor (Commissioners). Anita Mazzoleni, Gowan Pickering and David Caygill are Associate Members of the Commission and Helen Cull QC and The Hon. Sir Ian Barker QC 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, 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 at all times 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.

Capability and Resourcing

Capability Building

The Commission's responsibilities for economic regulation are comprehensive and require a high level of expertise and skill. The Commission continues to experience growth in the scope and complexity of its work reinforcing the need for it to utilise its resources effectively and efficiently. This drives the Commission's focus on improving business processes, making efficiency gains, and setting appropriate work priorities and trade-offs.

Each year the Commission sets initiatives to improve productivity and performance. The key strategies this year, as detailed in the Statement of Intent for 2008-2011 include a focus on maximising impact, sound leadership at all levels of the organisation, and continuing to strengthen capability.

In 2008 a baseline review of the Commission's funding arrangements has been carried out by MED and Treasury. The baseline review is recommending increased funding over the next five years to address capability and capacity issues.

Resourcing for 2008/2009

The Commission has offices in Wellington, Christchurch and Auckland and currently has 173 staff. The staffing level has been growing steadily over the past few years due to legislative change placing increased requirements on the Commission. The Commission's operating expenditure budget is \$42.765million (GST exclusive), across the following output appropriations in accordance with the 2008/09 SOI:

Appropriation		2008/09 Expenditure (\$ m)
Commerce	General Market Regulation	15.495
	Dairy Sector Regulation	0.300
Communications	Telecommunications Sector Regulation	8.040
Energy	Electricity Sector Regulation	5.630
	Gas Sector Regulation	0.300
	Regulatory Principles & Guidelines (now referred to as Input Methodologies)	3.000
Non Departmental Other Expenses	Major Litigation	10.000
TOTAL		42.765

The Commission also earns income from Commerce Act fees, interest, cost recovery and some court awarded costs.

The Commission's major litigation programme is funded in part by a Non Departmental Other Expenses appropriation (the Litigation Fund) of \$10.500 million for the 2008/2009 financial year, for managing significant litigation cases arising out of any part of its responsibilities that meet stated criteria. Of that fund \$2.500 million can be transferred to Vote Commerce to enable the Commission to provide internal resources to undertake its major litigation and create efficiencies. The Commission is required to report to the Ministry of Economic Development on the efficiencies achieved. A further \$0.500 million is provided to create a cost reserve up to a maximum of \$3.0 million to help manage adverse cost awards.

Most of the Commission's activities under the three sector-specific regimes (dairy, energy 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 Dairy Industry Restructuring Act, some of the Commission's activities are funded solely by the Crown. In each area litigation is funded by the Crown.

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. The Commission is also subject to the Official Information Act and can be subject to an Ombudsman inquiry.

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

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

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

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

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.

Most of the Commission's adjudication decisions (which are published) can be appealed to the High Court and/or are amenable to judicial review. 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'.³ Often the Commission must appear to represent the public interest.

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 prosecutes its allegations of contravention before the courts.

³ Goodman Fielder Limited v CC [1987] 2 NZLR 10,20 (CA).

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

Independence

The Commission is an independent Crown entity under section 7 and Part 3 of schedule 1 of the Crown Entities Act 2004. The Commission is not subject to direction in its enforcement and regulatory control activities. The independence of the Commission reflects the nature of the agency's enforcement and regulatory roles.

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

Section 19A of the Telecommunications Act provides an equivalent mechanism for the Commission to have regard to the economic policies of the Government in the context of telecommunications regulation.

The Commission provides independent advice to Government on implementation issues that arise as a result of any legislative changes to the Acts it has responsibility for. It also provides advice to the Minister of Communications about the scope of regulation of telecommunications. The Minister can request the Commission to commence an investigation into the scope of telecommunications regulation, although the Commission must satisfy itself that there are reasonable grounds to do so. The Minister can accept or reject the Commission's recommendations as to the scope of regulation, or ask the Commission to reconsider the recommendations. Other than through legislative amendment, the Minister can only change the scope of regulation following a recommendation from the Commission.

Commission Powers

The Commission's activities cover enforcement (investigations, litigation, and the provision of information to the public) and regulatory control (adjudications and reports to Ministers).

In carrying out its functions, the Commission is provided with the statutory power to require companies and individuals to provide information and to appear before the Commission to give evidence. The Commission is able to use search warrants. A warrant is issued by the District Court after first satisfying a judicial officer the warrant is

appropriate. The Commission also has the power 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.

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.

Other Actions the Commission Can Take

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.

Cease and Desist Orders

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

Orders can be made to stop cartel behaviour, including deals between competitors to set the price of goods they compete in, market rigging, or joint action by a group of businesses to block competitors coming into the market. Orders can be made to stop arrangements between businesses that have the effect of lessening competition, such as discounting arrangements. Orders can also be made to stop exclusive dealing in certain circumstances by parties with market power.

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

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

- to prevent a particular business or consumers from suffering serious loss or damage:

- in the interest of the public.

The Cease and Desist provision has been used once since the Act was introduced. This was successful in restoring competition in the market for marshalling at Northport and demonstrated the value of taking swift action against anti-competitive behaviour. Although the provision has not needed to be used recently, it is an important tool in the Commission's toolkit and the fact that it exists has been sufficient, on occasions, to persuade businesses to change their behaviour.

Enforcement Policies

Leniency Policy

In November 2004, the Commission released a Leniency Policy specifically aimed at breaking cartel behaviour. The purpose of the Policy is to offer immunity from Commission initiated proceedings to the first person or company involved in a cartel to come forward with information about the cartel and co-operate fully with the Commission. The policy does not give immunity to third party claims – only to Commission initiated prosecutions.

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

Nine applications for leniency have been received since the Policy was introduced in late 2004 in addition to cartel activity that has typically been identified through its clearance programme. The Commission has successfully prosecuted a cartel in the chemicals industry, has two cases currently before the courts, settled one case, found no breach of the law in two cases and has four more cases nearing the investigation phase.

The leniency policy is currently being reviewed to identify ways of further improving detection by increasing the incentives for cartelists to come forward.

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.

The Co-operation Policy is also being reviewed this financial year with the aim of encouraging greater co-operation with the Commission. This is expected to result both in reduced investigation and litigation costs.

Key Relationships with Government Departments

The Commission has a number of key relationships with Government 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 that support consumer protection. It has the primary role helping consumers understand their rights.

Ministry of Agriculture and Forestry (MAF)

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

The Commission also has working relationships with other regulatory agencies including the Electricity Commission, Police, SFO and Securities Commission.

International Relationships

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

Australia, Canada, Taiwan and United Kingdom

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

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

International Co-operation

As a member of the OECD, New Zealand complies with the 1986 recommendations on international co-operation relating to the notification of investigations or proceedings to other member countries if their interests may be affected. The criteria are whether an investigation or proceeding relates to the conduct of a person resident or carrying on

business in another member country, or whether the conduct is likely to have an effect on competition in a market in another member country.

The Commission is a member of the International Competition Network (ICN) and the International Consumer Protection and Enforcement Network (ICPEN), both of which are associations of enforcement agencies. Having effective competition laws and enforcement are considered to be vital in obtaining the confidence of potential foreign investors and in attracting finance for development. It is also a requirement that is often raised by other jurisdictions when negotiating Free Trade Agreements.

In addition the Commission meets regularly with regulatory agencies from developing nations in the Asia Pacific to assist their development of economic regulatory regimes. The Commission meets with the Australian Competition and Consumer Commission (ACCC); the Australian Energy Regulator (AER) and the Utility Regulator's Forum (URF), whose members consist of the ACCC and all state-based economic regulators and the New Zealand Commerce Commission.

VOTE COMMERCE

Commerce Act

The Commerce Act is a set of generic competition laws that regulate anti-competitive market behaviour or structure in any market. It enables mergers and acquisitions that do not substantially lessen competition to be approved protecting against claims the acquisitions are anti-competitive, giving greater certainty to business. Anti-competitive behaviour and structures may be authorised if the overall public benefits outweigh the competitive harm.

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

The Electricity Industry Reform Act, introduced in 1998, seeks to reform the electricity industry to better ensure that costs and prices in the electricity industry are subject to sustained downward pressure; and the benefits of efficient electricity pricing flow through to all classes of consumers by effectively separating electricity distribution from generation and retail; and promoting effective competition in electricity generation and retail. This Act has been recently amended, giving the Commission the additional responsibilities as outlined below.

The Commission's enforcement tools include investigations, litigation, development of competition frameworks (which includes providing advice to officials on the impact of proposed legislative change as well as the development of the Commission's position on economic and legal matters) and the provision of public information.

The Commission intervenes in markets to underpin the competitive process. It does not take action on behalf of individuals. Nor is it able to investigate all competition issues it is aware of. The Commission selects which matters to investigate based on a published set of enforcement criteria. These criteria also help inform the Commission's enforcement decision, including whether to warn, settle or litigate.

The current SOI signals the Commission's intention to speed the investigation and resolution of cases by streamlining processes and widening its toolkit, including by initiating settlement procedures, producing guidelines and increasing the activities involved in promoting the benefits of competition. Of particular note, we are increasing the use of settlements: these are often 'in court', achieving both the desire for pragmatism as well as the need to send a strong deterrent message to businesses.

As the environment in which the Commission operates becomes increasingly more concentrated and complex, and as cases are increasingly global in nature, the cost of the Commission's cases have increased. At the same time, the Commission has also

significantly lifted its impact. Cartel cases, especially those initiated through leniency, have been prioritised because of their significant impact on the economy.

The leniency programme was introduced to improve the detection of cartels and destabilise them. It has been more successful than anticipated and the cases have proven more difficult to investigate. The success of the leniency programme, along with more complicated clearances, has left the Commission with little ability to investigate other important matters such as domestic cartels, abuse of market power allegations, EIRA applications and investigation of mergers or acquisitions that have gone ahead without Commission clearance.

Each of the Commission's major competition programmes is discussed in more depth below.

Co-ordinated Conduct, including Cartels

Detecting and taking action to stop and deter cartel activity is the Commission's highest priority in the competition area. Cartels are usually formed by competitors whose aim is to limit or eliminate competition between them with a view to raising prices and profits. They typically involve agreements to fix prices, limit output, share markets, rig bids or allocate customers or territories.

Internationally, cartels are considered to be the most egregious form of anti-competitive conduct because of the significant economic harm they cause: they typically involve inputs to a product or service, increase prices throughout the value chain and are very difficult to detect.

Studies by the Office of Fair Trading (OFT) in the United Kingdom have shown that stopping one cartel alone saved consumers GBP3 billion. This can be compared with the benefits of merger control which was estimated to save a further GBP52 million (bearing in mind that the OFT does not deal with the most substantial mergers) and stopping other anti-competitive conduct, which saved some GBP64 million.

In New Zealand, the Koppers Arch case, a cartel in the wood chemicals industry, has resulted in more than \$7 million in fines. The economic detriment was not estimated in this case. The Commission has, however, begun the process of estimating detriment. A preliminary assessment in one matter currently under investigation suggests that economic detriment may have been as high as \$200 million during the period of the cartel's operation.

To send the strongest possible deterrent message to businesses, the Commission needs to take court action and to ensure that the courts are fully informed of the extent and economic impact of the anti-competitive behaviour it is considering. Not to take action in cartel cases, for example, risks international cartels operating from New Zealand with significant economic harm to the New Zealand economy and New Zealanders. It further risks undermining international confidence in New Zealand's trading environment. Moreover, it risks an increase in domestic cartel activity.

Investigating and taking action against international cartels has proven to be more complex than originally envisaged. Challenges to the Commission's jurisdiction and statutory powers are common, obtaining co-operation from and access to key individuals resident overseas is difficult, New Zealand is not a priority for most applicants (who typically apply as part of an international initiative to apply in all jurisdictions who enforce against cartels) and we are constrained in our ability to share evidence with our international counterparts.

The Commission's initial leniency and co-operation policies have been very successful in meeting these challenges by improving detection, particularly of international cartel activity. The current work programme in this area is large and there are strong indications that international cartel leniency applications will continue to increase.

To cope with this increase the Commission is currently reviewing its leniency and co-operation policies to seek ways of strengthening the incentives on leniency and co-operating parties to apply and co-operate. This is particularly important not only to help manage the pressures caused by the large and growing cartel workload, but because the Commission must lay charges within a three year statutory limitation period.

We are also developing sentencing guidelines that will specify the Commission's approach to sentencing submissions, including the level of discounts the Commerce Commission is likely to recommend to further encourage co-operation. This is to address concerns by businesses in this area. Ultimately it is for the courts to decide, but the Commission will work with co-operating parties to submit agreed penalties. In addition, we have strengthened our relationships with international agencies to both learn from their experience and encourage better informal information-sharing.

The Commerce Act at present has only civil penalties for cartel conduct. The Commission has been following international developments such as criminalisation of cartels, which is being introduced in Australia, Canada and some member states of the EU, as this has proven successful in deterring cartels and encouraging applications for leniency in the United States. Organisations, such as the OECD, also consider this to be best practice. Of particular interest is the fact that the proposed Australian legislation includes a maximum 10 year term of imprisonment for individuals found guilty of participating in a cartel.

The Commerce Commission (International Co-operation and Fees) Bill 2008 is designed to assist enforcement by allowing the Commission to assist and be assisted by equivalent overseas regulators. The Commission would be authorised to use its statutory powers to provide investigative assistance to overseas competition and consumer regulators, and to provide compulsorily acquired information to them, subject to specified safeguards and to reciprocity. The Bill is aimed primarily at the Commission's relationship with the ACCC, but the provisions could be used for authorities in some other jurisdictions also. The Bill was introduced into Parliament in September 2008, but did not obtain a first reading.

The Commission currently has five cases before the courts relating to anti-competitive arrangements, four of which relate to alleged cartel conduct: Wood Chemicals, Credit Card Interchange Fees; Gas Insulated Switchgear, Waikato Pathology, and Visy. Three of these are briefly summarised in Appendix 3, as well as the air cargo investigation under which we have laid charges for failure to co-operate with the Commission.

Abuse of Market Power/Unilateral Conduct

Abuse of market power, often referred to as unilateral conduct, can take the form of anti-competitive conduct. This can involve large companies using their market power to prevent new entry or squeeze competitors out of the market. Substantially lessening competition in this way reduces incentives to growth and innovation as well as consumer welfare. Section 36 of the Commerce Act addresses this area.

The Commission has successfully brought litigation it considered involved serious abuse of market power in the past, however it has experienced less success of late. This is consistent with international experience where a number of jurisdictions, including Australia, have been reviewing their equivalent provisions. The incoming US President has also announced a similar review, along with the Canadian Government.

Having the ability to take action against abuses of market power is particularly important in small economies such as New Zealand where levels of concentration are greater due to the need to gain economies of scale. And, although cartel cases are taking first priority along with statutory determinations, clarifying the law in this area also remains important.

The Commission has two major cases before the Courts. It is currently appealing a recent High Court decision involving Telecom New Zealand Limited and its introduction of the 0867 arrangements. The Commission is awaiting a High Court judgment in an access pricing case also involving Telecom. Importantly the Commission is undertaking a review of its own approach to s36. The Commission is appointing an expert panel and will be consulting with relevant parties to see what the underlying issues are in prosecuting such behaviour.

In addition to the two s36 cases before the courts (Data Access Pricing and appeal of the Telecom 0867 decision) the Commission is progressing investigations on a further six cases. The two court cases are summarised in Appendix 3.

A current Commission investigation into complaints about electricity industry is being looked at under both the unilateral (s 36) and co-ordinated conduct provisions of the Commerce Act (s27/30). The Commission needs to consider whether any of the generators or retailers have substantial market power. As a first step, the Commission has engaged Professor Frank Wolak from Stanford University, an internationally recognised expert in electricity markets, to assess whether parties in the wholesale electricity market appear to have market power and whether there are indicators that market power may have been used for an anti-competitive purpose. He has been engaged to report on the

wholesale and retail markets. In addition, because retailers are now vertically integrated with wholesale generation, he has been engaged to assess the effect of vertical integration on market power.

At the same time, the Commission is exploring the extent to which parties in the electricity markets may have acted in a co-ordinated manner to influence prices.

The first of Professor Wolak's reports, into the wholesale market, is expected to be complete by the end of the year. The Commission has received requests for release of this report and is obliged to consider releasing it under the Official Information Act in the public interest.

Determinations

Under the Commerce Act, the Commission considers clearance applications for proposed business acquisitions, and applications for authorisation of certain prohibited contracts or arrangements that would normally be considered a breach of the Act. The Commission will grant an authorisation if it finds that the benefits of the acquisition or arrangement outweigh the detriments.

Mergers and acquisitions can have significant benefits for the economy through businesses combining their activities to develop new products or to lower costs. Some mergers may, however, substantially reduce competition and either create or strengthen the position of players with substantial market power.

Clearance applications have become significantly more complex over the past five to six years. The proportion of clearances involving a reduction in players from three to two, or from two to one, has increased. This appears to be symptomatic of a more concentrated economy although the fact that the Commission publishes detailed reasons for its determination decisions may also be sending clearer signals to the market about which mergers or acquisitions need to apply for clearance and which do not. Despite the increase in complexity, the number of applications declined by the Commission has remained steady at between one and three per year.

The Woolworths and Foodstuffs application to acquire up to 100% shares in, or assets of, The Warehouse is a good illustration of the complexity of decisions faced by the Commission. The Commission's case focused on its concerns that in the supermarket sector there was, in effect, a duopoly, except in the three regions where The Warehouse has opened a supercentre. There are high barriers to entry in the industry, and The Warehouse is uniquely placed to compete with the supermarkets. Although the Commission lost its case in the High Court, the Court of Appeal recently overturned that decision. Given the announcement from the Warehouse that it plans to withdraw from the supermarket business Woolworths has withdrawn its application for leave to appeal to the Supreme Court.

The Warehouse case was also important in that it provided greater clarity of the law. In particular, it clarified that in determining whether a merger or acquisition was likely to result in a substantial lessening of competition, the Commission should assess the

competitive effect of that merger against all likely counterfactuals (a counterfactual is what might happen if the merger or acquisition were not to proceed). It also clarified the scope for the Commission to decline a merger if in real doubt about its effect, where market developments are uncertain.

On average, the Commission handles 17-23 clearances a year. Economic activity was particularly high last year, however, and the Commission decided 26 clearance applications. In the current year to date, applications have reduced.

The Commission has a statutory timeframe of ten working days for completion of clearances but this is extended with the agreement of the parties. In practice, the Commission has a target of 40 days which compares very favourably with similar overseas jurisdictions. Last year it reduced the average from 43 days to less than 38 days following the introduction of new processes.

The previous Government's recent review of Part 5 of the Commerce Act proposed a change in statutory timeframes from 10 to 40 days. This is consistent with the recommendations of an independent review undertaken for the Commission. In addition, the proposed amendments included:

- giving the Commission sole discretion to hold a conference when determining an authorisation;
- restricting third party appeal rights against a Commission decision in restricted behaviour authorisations if they can satisfy the court that they have a significant interest in the determination (for merger authorisations, third parties will have no ability to appeal and can only seek judicial review); and
- removing the requirement for parties to halt conduct while the Commission considers an authorisation. The Commission would need to apply to the court to halt conduct.

The Commission has also recently reviewed its clearance application process and following external consultation will shortly publish both a new application form and a process guide. This review was designed to better inform applicants as to the Commission's process and timelines, improve the quality of information provided by applicants and further speed decision times.

The Commission is also currently developing a streamlined authorisation process. The aim is to reduce the time taken for less complex applications, for example, where the authorisation does not require significant quantification or is required for a limited time period. We expect this will lead to a greater number of applications for authorisation and fewer calls for exemptions to the Commerce Act.

Market structure investigations

Businesses do not have to apply for clearance to merge or acquire as the regime is voluntary. The Commission maintains a surveillance programme where merger and acquisition activity is identified. If the Commission considers that a proposed or actual

mergers or acquisitions may lead to a substantial lessening of competition in the relevant market, and the parties have not applied for clearance, it can investigate. If prosecuted, the acquiring company is liable to pay a penalty. In a recent case, the court ordered NZ Bus to pay over \$1.1 million in penalties and litigation costs.

In 2007/2008 the Commission resolved three market structure investigations, the most significant of these was Carter Holt Harvey's acquisition of The TDC Mill in Northland.

In this case, the Commission initiated an investigation into the acquisition by Carter Holt Harvey Limited of TDC Sawmills Limited because it had not applied for clearance and the Commission became aware that just after the acquisition Carter Holt Harvey Limited announced that it would increase prices for structural timber. After substantial investigation and analysis, the Commission's concerns were alleviated when in late 2007 prices began falling. This fall seemed largely to be in response to competition resulting from the expansion of Red Stag Timber Limited. As a result the Commission made a decision to conclude the investigation without the need for enforcement action.

Electricity Industry Reform Act

The Commission has an existing enforcement and adjudicative role under EIRA. The aim of EIRA is to benefit all electricity consumers by making the generation, local distribution and retail sectors of the electricity industry, more efficient through the promotion of effective competition in generation and retail markets, and by curtailing the natural monopoly powers of local distribution networks.

It further aims 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. The EIRA achieves this by separating distribution from generation and retail. Doing so eliminates the ability and incentives of a monopoly lines business to restrict access to its network by competing retailers, or to use monopoly rents in its lines business to cross-subsidise its retail customers and its investments in generation.

The Commission plays a role in ensuring this separation occurs through the enforcement of the ownership separation, corporate separation and arms length rules in the Act. The Commission also has an adjudicative role.

The Commission considers applications for exemption from the Act and whether it is appropriate to extend the application of the Act to businesses that are otherwise disregarded for the purpose of the EIRA.

EIRA was amended in August 2008. The Commission's role will, as a consequence of amendments to EIRA, expand to include:

- determining whether investment in generation should be deemed 'local';

- monitoring obligations to publish certification of compliance with various obligations under the Act;
- a lines business involved in 5MW or more of generation that is retailing more than 5GWh per year on its network is required to publish an internal Use of System agreement on its website and to certify compliance with it;
- a lines business is required to disclose annual electricity sold on a form to be prescribed by the Commission and to certify that the quantity sold did not exceed limits for 'local generation' and publish certification on its website; and
- a lines business is required to certify directors' compliance with arms length rules and publish certification on its website.

EIRA work is completed as the Commission's other work programme allows. It will be developing guidelines for publication to assist parties with their EIRA compliance in this financial year. Presently, the Commission is seeking information from parties granted interim exemptions under the previous Act to determine whether these are still required.

Fair Trading Act

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

Strategically, there are two principal areas of focus for the Commission in this area. The first is litigation to address major cases involving egregious industry practice and/or high consumer detriment. This is essential to protect the integrity of the New Zealand consumer market. The second is improving voluntary compliance through a concerted programme of enforcement action outside the Courts and general education.

The Commission acts to ensure that consumers can be confident in the accuracy of the information they receive from traders. Enforcement activities range from issuing warnings and entering into settlements to taking court action. The Commission also provides information and guidelines to businesses, trade associations and consumers to encourage behaviour that will result in competitive markets.

The Fair Trading Act prohibits misleading or deceptive activity 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 of consumer detriment are targeted. It has also targeted cases where the Fair Trading Act is better able to deal with competition issues than other legislation, typically by ensuring that consumers have the information on which to base their purchase decisions.

The major issue facing the Commission in respect of the Fair Trading Act is progress in amendments to the Fair Trading Act to bring New Zealand into line with Australia, especially in relation to Substantiation and Court Enforceable undertakings. Without these amendments, the Commission is forced to conduct long and expensive investigations to deter offending.

The Commission will focus on its priority areas of sustainability ('greenwashing'), retail telecommunications, and financial products. The Commission will also continue to improve its effectiveness by pooling resources and coordinating enforcement action with sister organisations in overseas jurisdictions.

Guidelines and Codes of Practice

The Commission is required by s6 of the Act to make available general information about rights and obligations of traders and consumers. A comprehensive review has begun, starting with safety standards, which will update general and specific guidance. This will be in a format more readily updated and accessible by traders, traders' associations, consumers and consumer advocacy groups. For example, a sustainable ('green') guide based on the Australian model has just been developed. Others to follow include 'Made in New Zealand' labelling guidance for traders and Calculating Fees guidance for the credit industry.

Information

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

The Commission obtains information about potential breaches of the law from both its own surveillance and inspection activity and from the public. Through its Contact Centre it receives some 15,000 contacts each year from members of the public who are concerned about consumer-related issues and it is estimated that 3,000-4,000 of these indicate 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 enforcement criteria are published on the Commission's website.

The Commission completes approximately 400 investigations per annum in the Fair Trading and CCCF area and has, on average, 60 investigations open at any one time. In the 2007/2008 year, the Commission completed 239 general Fair Trading investigations and 46 standards investigations; and concluded 21 criminal prosecutions. At 30 September 2008 there were 18 prosecutions still active; 109 active Fair Trading investigations and nine active Standards investigations.

Credit Contracts and Consumer Finance Act

Strategically, the Commission sees increased activity to encourage compliance with the CCCF Act as one of its highest priority areas, due to shaken consumer confidence in the finance industry and the important role a competitive lending market will play in strengthening the New Zealand economy.

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

The Commission has found more extensive and systematic non-compliance than envisaged when the Act was passed resulting in a higher and continually rising, workload in this area. This has been managed by transferring funds and detracting from Fair Trading Act activity. As analysed in the Baseline Review, despite this transfer the Commission has struggled to meet the widespread extent of non-compliance. Nevertheless, returns to consumers and the Crown through enforcement action identified through CCCF action have totalled approximately \$6.1 million from 2006 for an investment of about \$2.7million. (This figure includes \$3.1 million in refunds to GE Money customers under the Fair Trading Act – but which resulted from a CCCF Act investigation.)

The Commission is now moving into a litigation phase after spending two years laying the foundations by raising awareness of, and educating the public and credit industry about, the new act. Major prosecutions are envisaged in the near to medium term to clarify whether the Commission interpretation or widespread industry practice reflect the intent of the Act. The major issues under investigation include the reasonableness of fees, the calculation of early prepayment fees, failure to meet disclosure standards and unreasonable requirement to obtain insurance. Due to the sums of money at stake, it is expected that investigations will be complex and lengthy, and that subsequent litigation will be stoutly defended.

Dairy Industry Restructuring Act

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 purpose of the regulations is to:

- protect the position of companies that previously bought milk from the predecessor companies that formed Fonterra;
- protect domestic consumers from monopoly pricing; and
- provide an entry path for new processors into the milk processing industry.

On 13 August 2008, the Minister of Agriculture announced the outcomes of a review of the Dairy Industry Restructuring (Raw Milk) Regulations 2001. The Regulations impose obligations on Fonterra Co-operative Group Ltd, a vertically integrated cooperative company which handles approximately 95 percent of raw milk production. The Regulations require Fonterra to supply raw milk to competing dairy processors, subject to an aggregate annual ceiling, at a regulated default price designed to mirror the price Fonterra pays its shareholding farmers.

On 20 October 2008 the Dairy Industry Restructuring (Raw Milk) Amendment Regulations were published by Order in Council. These come into force on 1 June 2009 and set a permanent 600,000 million litre cap on the raw milk that must be offered at the default price. Previously the quantity was due to revert back to 400 million litres in the 2009/10 season.

The review also sought to address industry concerns with the prescribed allocation mechanism and terms of supply by Fonterra, and a Regulations Review Committee recommendation to amend the default price terms. The previous Government proposed amending the regulations to establish an auction mechanism for allocating raw milk which would take effect from 2010/11. In the meantime, the amended regulations have

introduced a provision to allow the pro rata rationing of raw milk if excess demand occurs.

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. It is currently determining two access disputes between Fonterra, Kaimai Cheese and Grate Kiwi. Both companies have sought access to raw milk at the default price and seek to have that raw milk delivered to another processor for pasteurisation.

As neither of the parties processes the raw milk directly, the dispute concerns the definition of ‘independent processor’ as outlined in the Act and the ability of an independent processor to contract a third party to undertake part or all of the processing of the default milk. A draft decision has been issued in the Applicants’ favour. A final determination will be made before Christmas.

VOTE COMMUNICATIONS

The purpose of this output is to ensure telecommunications services are provided at competitive prices and service providers face incentives for efficient investment.

To achieve this output, the Commission:

- determines terms and conditions for access to regulated telecommunications services under Part 2 of the Act;
- determines the cost of Telecommunications Service Obligations, and how these costs will be allocated among industry participants;
- makes recommendations to the Minister of Communications as to the scope of regulation of telecommunications services;
- makes recommendations to the Minister of Communications as to whether to accept undertakings lodged by access providers in lieu of regulation;
- conducts inquiries, reviews and studies relating to the telecommunications industry, and publishes reports, summaries and information about these activities;
- monitors and enforces Telecom New Zealand Limited’s operational separation undertakings;
- develops and administers accounting separation and information disclosure requirements;
- considers telecommunications access codes which have been submitted to the Commission by the Telecommunications Carriers’ Forum (TCF) or develops telecommunications access codes itself; and
- enforces the provisions of the legislation using the new enforcement tools provided in the Telecommunications Amendment Act (No 2).

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.

Background

Significant changes were introduced to the Telecommunications Act in 2006, which represented a fundamental shift in policy in this area. The changes were designed to give more scope to the Commission to identify problems in telecommunications markets at an early stage, and to respond rapidly to them.

A number of new regulatory tools are now available to the Commission. The Commission can set terms and conditions for regulated services that apply to the entire industry, without requiring a bilateral dispute as a trigger. Telecom has been operationally separated into retail, wholesale and network units in order to ensure non-discrimination in the supply of network and wholesale services to competitors. The Commission has been given explicit monitoring tools to assist it to anticipate problems and to track the effectiveness of regulatory solutions. New information disclosure tools allow the Commission to provide more transparency to industry around Telecom's costs and behaviour. Companies can now lodge undertakings setting out terms and conditions for supply of services, which can be accepted as an alternative to potential regulation.

The Commission moved quickly to make early decisions on the basic features of the new regime. The Commission finalised terms and conditions for the key wholesale services used as inputs to retail broadband services by Telecom's competitors. The Commission also began to use the new monitoring tools in the Act to track progress in the most significant telecommunications markets. The Commission has issued quarterly and annual reports tracking key indicators of performance in telecommunications markets.

Investment in telecommunications infrastructure remains strong, as Vodafone expands its 3G network coverage, and Telecom invests in a new mobile network and its cabinetisation programme. As part of the Operational Separation Undertakings, Telecom has committed to ensuring that 80 per cent of existing PSTN lines will be technically capable of speeds of 10 Mbps or better by 2012. Telecom has also committed to migrate all its customers off traditional PSTN services by 2020.

Key Issues

Broadband Services

The Commission noted in its Annual Report on Telecommunications for 2007 that the New Zealand broadband market continued to grow strongly. By September 2007 broadband surpassed dial-up as the most common means of connecting with the internet. The most recent OECD report to June 2008 indicates that New Zealand has the 6th fastest rate of broadband growth in the OECD. New Zealand broadband take-up was ranked at 19 in the OECD, with 20.4 out of 100 inhabitants with broadband subscriptions.

The Commission found in its 2007 report that the price of residential broadband services in New Zealand compared favourably to that in other similarly developed countries, with prices for low, medium and higher users all ranking in the top third of the plans surveyed. There is healthy competition, with Telecom retailing around 60 percent of all broadband

connections. In the retail market for broadband over phone lines, Telecom's competitors' share of the growth in connections rose to over 70 percent for the final quarter of the year.

The Commission's local loop unbundling determination contributed to very competitive bundled broadband promotions appearing in the market. The first unbundled lines became available in early 2008, and service providers used them to offer competitive prices for a bundle of fixed line, national calling and broadband services, coupled with unconstrained data speeds and high data caps. New packages have been developed by different service providers since then, as more players take up unbundled loops. Orcon, Vodafone, CallPlus and Actrix have entered the market for these services, while TelstraClear has announced its intention to do so. While the initial entry has tended to take place in Auckland, expansion in Wellington and Christchurch has been announced. Vodafone has offered local loop services on a wholesale basis to other providers.

In 2007, the Commission engaged EpiTiro, an independent monitoring company, to measure the quality of broadband service in New Zealand. Early data indicates that the quality of broadband services supplied by the major Internet Service Providers is increasing at a rate that reflects higher levels of competition.

Regulated Broadband Services

These positive developments in the broadband market reflect a successful model of regulatory intervention based on providing access to Telecom's copper access network to its competitors. The Commission set price and non-price terms and conditions for the fundamental access services needed to support competition in broadband services in New Zealand as its key priority, including:

- unbundled copper local loop and related co-location services;
- unbundled bitstream access (UBA) services; and
- backhaul and related co-location services.

The Commission's determinations are complete commercial arrangements which will allow competitors to take the services from Telecom without the need for any separate agreements.

Unbundled Local Loop Services

The local loop is the copper telephone wire that runs from a Telecom telephone exchange to an end-user's premises. Unbundling of the local loop allows other telecommunications providers to use Telecom's copper network to deliver services to their own customers, by installing their own equipment in exchanges. The final determinations set monthly rental charges for access to the local loop service at \$19.84 per month for urban areas and \$36.63 per month for non-urban areas.

Telecom has announced its cabinetisation plans which will reduce the number of lines in exchanges that can be accessed by Telecom's competitors. The final determination requires Telecom to provide forecasts and notice to telecommunications providers of any planned replacement of copper local loops from the exchange by fibre to the cabinet (cabinetisation). This will allow telecommunications providers to invest with confidence, without impeding Telecom from deploying more fibre in the network. As noted above, despite Telecom's cabinetisation plans, there has been considerable investment by service providers in unbundled loops.

In addition, the Commission is progressing sub-loop unbundling, which will allow other telecommunications companies to access lines that are fed directly from Telecom's distribution cabinets. The Commission has released a draft report on the sub-loop service, and expects to complete its final determination early in 2009.

Unbundled Bitstream Services

The bitstream service is a wholesale service that allows telecommunications companies to supply a range of broadband services to retail customers. A bitstream service has been available as a regulated service since 2005. The new Unbundled Bitstream Access services offer greater functionality than previous bitstream services. The Commission set prices for a Basic UBA service, and three Enhanced UBA services with different settings for quality of service. The Enhanced UBA services allow telecommunications companies to provide good quality Voice over IP and other real-time services over broadband. Telecommunications companies may now choose to supply UBA-based services without a traditional phone service (naked DSL). This means that consumers will no longer be required to purchase a standard telephone service to have access to a broadband connection.

Backhaul Services

These services allow Telecom's competitors to get access to transmission capacity between Telecom's local exchanges or data switches, and the competitors' networks. Backhaul for unbundled local loops is regulated only where Telecom faces limited competition. The Commission determined that Telecom faces competition in most North Island primary and secondary links of the unbundled local loop Backhaul Service. The Commission determined that Telecom faces limited competition on most South Island primary and secondary links.

Issues Going Forward

The current regulatory framework, while successful in delivering results to consumers, is based on the delivery of services over Telecom's copper network, either from the exchange or the distribution cabinet. Service provider take-up of the service appears to indicate considerable resilience in the face of Telecom's current cabinetisation programme. Successful implementation of sub-loop unbundling will also provide them with greater confidence in deploying loop-based services. However, given the pace of

technological change, it is not clear that the access technology will remain stable in the medium term. Choices around the pace of deployment of fibre will have a major impact on the effectiveness of competition, and consideration may need to be given to migrating providers to alternative access services.

In the longer term, network operators may be changing the way services are supplied to customers in quite fundamental ways, through the development of next generation networks. It is not yet clear what the impact of such changes will be on traditional models of interconnection and access regulation. As part of its obligations under the Operational Separation Undertakings, Telecom is consulting the industry over a range of issues related to its plans for Next Generation Networks.

The Commission is undertaking a major project scoping the impact of next generation networks. The Commission will be holding a conference in February 2009 which will give the opportunity for public debate and discussion about the key challenges posed, and opportunities provided, by such networks to the competitive environment. There is at this stage no industry or international consensus on the likely shape of the regulatory environment going forward.

Mobile Markets

Mobile markets have showed some positive developments in New Zealand, such as higher penetration rates, increased usage and falling prices. The introduction of new calling plans has benefited some mobile users, particularly through cheaper calls to selected users on the same network. However, mobile services markets continue to present challenges in terms of consumer outcomes when compared to markets overseas. By international standards, average mobile calling per user remains low, and prices remain high.

The structure of the mobile services market is highly concentrated, although it is one of the few telecommunications markets in which there has been successful entry. Vodafone has been able to capture more than half the market share in terms of subscribers, and a much higher proportion of industry revenue. Competitive tension was compromised by the use of different network technologies by Telecom and Vodafone, which made customer switching much more difficult than in other markets. Telecom has now opted for a mobile technology which is more compatible with Vodafone's. Both companies have announced a transition to 3G mobile technologies, which have greater functionality than earlier generation mobile technologies, but Telecom has been relatively slow to deploy 3G technology on a significant scale.

The Commission has continued its strategy of seeking to lower barriers to entry for new efficient entrants to the market. The Commission has encouraged entry by a new network builder, in preference to entry at the wholesale level, as this has more potential to make a significant positive impact for consumers. NZ Communications remains the most likely entrant, and has attracted capital and started investing in facilities,

telecommunications equipment and staff. The Commission expects the company to launch services in 2009.

Co-location/National Roaming

In 2007/08 the Commission completed investigations into whether the currently regulated mobile services of co-location and national roaming should be amended, and whether regulation of these services should be extended to include price. The co-location service allows competitors to co-locate their facilities on the towers of incumbent mobile operators. The roaming service allows new entrants to serve their customers when they leave the coverage of the entrant's network, by using the incumbents' networks to carry their traffic.

The Commission recommended that regulation of the roaming and co-location services should not be extended to include price. The Commission recommended to the Minister that some amendments be made to the roaming service, to make it technology-neutral, and to clarify some of its requirements. The Minister of Communications accepted the Commission's recommendations.

However, the Minister asked the Commission to consider whether, in light of new information that had arisen since the Commission's investigation, the roaming service should become a 'specified service'. In effect this would be a fresh investigation into whether the price should be regulated. The Commission has the discretion to decide whether or not to launch such an investigation. The Commission is currently considering the new information, and will make a decision as to whether to commence the investigation by December 2008.

The Commission is setting non-price terms and conditions for co-location through a Standard Terms Determination. Co-location has been a long-standing source of friction in the industry between incumbents and entrants. The Commission has completed its consultative process, and expects to release a final Determination in December 2008.

Telecom entered into a co-location agreement with New Zealand Communications in early 2007, although no co-locations between the two have been finalised since then. Vodafone entered into a national roaming agreement with New Zealand Communications in late 2007, and in September this year entered into a Heads of Agreement with NZ Communications in relation to co-location on some of its sites.

Mobile Termination

Between 2004 and 2006, the Commission undertook investigations into whether mobile termination services should be regulated, and recommended to the Minister of Communications that such services be regulated. In 2007 Economic Development Minister Trevor Mallard rejected the Commerce Commission's recommendation to regulate mobile termination. Both Telecom Ltd and Vodafone separately entered into deeds setting out binding commitments related to mobile termination. The deeds provide

for a glide path of termination prices falling over time to 14 and 12c respectively for Vodafone and Telecom by 2012.

The Commission noted in its market monitoring work that there was a significant differential between the price charged for mobile on-net and off-net calls. Such rates are only likely to be sustainable if mobile-to-mobile termination rates between networks were significantly above cost. The Commission was concerned that high mobile-to-mobile termination rates might make it difficult for new entrants to attract customers from existing networks which offer low 'on-net' rates. The Commission sought industry feedback on whether it should commence an investigation into mobile-to-mobile termination rates for both voice and SMS, and released an issues paper on termination rates for industry comment. Some submissions called for the Commission to extend any such investigation to termination of fixed-to-mobile, as well as mobile-to-mobile calls. The Commission will decide whether to commence such an investigation by December 2008. The Commission recently announced it is commencing an investigation under Schedule 3 of the Telecommunications Act, into whether mobile termination access services should be regulated.

Vodafone entered into an interconnection agreement with New Zealand Communications in September 2008. The Commission considered whether an investigation is appropriate given the agreement. The current commercial agreement with Vodafone is restricted to NZ Communications, but a regulated rate or an undertaking would be applicable to all access providers and access seeker. The Commission considered that this may better give effect to the long term interest of end-users than a bilateral offer.

Operational Separation

The three-way operational separation of Telecom New Zealand – into fixed network, wholesale, and retail services - was required by the Telecommunications Act 2001. The Act set out the statutory process for the Minister to finalise legally enforceable Undertakings (as part of the 'separation plan') with Telecom. A plan for the three-way operational separation of Telecom New Zealand was approved on 30 March 2008 by the Communications and Information Technology Minister.

The Separation Undertakings are a deed between the Crown and Telecom which the Commission has the role to enforce. Within the document are a number of specific milestones and commitments that must be met by Telecom. Over time, these require Telecom business units to treat the other Telecom business units and external wholesale customers in an equivalent and transparent manner.

The Commission has worked closely with Telecom and the Independent Oversight Group (IOG) to ensure that the core processes for implementing the Undertakings are in place, and transparent to industry. To date Telecom has met almost all its milestones, although there has been one failure to do so.

The Commission wrote to Telecom in July advising that the first prima facie breach of the Separation Undertakings had occurred. It appeared that the breach was unintentional, and Telecom subsequently resolved the breach. It related to Telecom's failure to consult and provide information to the Minister of Communications and the Commerce Commission before 30 June 2008 about the method by which Telecom classifies customer service addresses. This information forms the basis of Telecom's commitment to migrate 80 percent of the country's lines from the old Public Switched Telephone Network (PSTN) network to an advanced broadband network at a minimum speed of 10 Mbps by 2012.

Under the Accounting Separation requirements of the Act, Telecom will be required to prepare financial and other information about its retail, wholesale, access, corporate and international business activities. This information will be publicly available and is designed to inform a wide audience about the operation and behaviour of Telecom's business activities. It will assist with identifying any cross-subsidies and supporting non-discrimination between Telecom's wholesale customers and its own retail group. In doing so it will complement the reporting required by the operational separation undertakings. The Commerce Commission issued a draft paper on the regulatory reporting requirements, outlining the financial information that Telecom must provide and the conditions it must follow when preparing this information. As set out in the draft paper, July 2008 to June 2009 will be a transitional year with the first set of financial information released in the second half of 2009. Full regulatory financial reporting will apply for the year July 2009 to June 2010.

Telecommunications Service Obligations

The Commission provides annual determinations of the cost of providing Telecommunications Service Obligations. There are two of these, one for local calling services, and one for the deaf relay service.

The local calling service is highly contentious. Under the TSO, Telecom is obliged to provide certain local residential telephone services to residential customers who may not otherwise be provided with those services at an affordable price. The Commission calculates the cost of those services, which are met by the telecommunications industry.

The Commission recently finalised its Determinations for 2004/05 and 2005/06 after extensive consultation. The Determinations have been challenged on legal and administrative review grounds by both Telecom and Vodafone, the major contributors to the cost.

For the 2005/06 year the Commerce Commission determined that the final TSO cost was \$58.2 million. Telecom bears approximately 69 percent of the TSO cost. The remainder is carried primarily by Vodafone and TelstraClear. The total cost for 2005/06 will be shared between Telecom, TelstraClear Limited, WorldxChange Communications Limited, Vodafone New Zealand Limited, CallPlus Limited, Compass Communications Limited, Teamtalk Limited, Woosh Wireless Limited and ihug Limited. The total cost is

shared in proportion to their liable revenues. The Commission will release draft decisions on TSO costs for 2006/07 and 2007/08 by the end of November 2008, and expects to finalise them in the first quarter of 2009. This will mean that the Commission will have cleared the backlog of TSO decisions.

COMMERCE ACT PART 4

Summary

The Commerce Amendment Act (2008) (Amendment Act) introduced a major revision of the regulatory provisions of the Commerce Act 1986. The Amendment Act came into effect on 14 October 2008 and repeals the prior Parts 4, 4A and relevant sections of Part 5 of the Commerce Act relating to economic regulation, replacing these with a new Part 4. Part 4 of the Act's overall aim is to promote the long-term benefit of consumers in markets where there is little or no competition by promoting outcomes consistent with those produced in competitive markets.

Part 4 aims to create greater certainty and to provide a broader range of regulatory instruments. In doing so it provides a 'fit for purpose' regime, by allowing alternative forms of 'lighter handed' regulation to full price control. Part 4 allows for the regulation of markets that exhibit natural monopoly characteristics; it provides for regulation of electricity distribution and transmission services; gas pipeline services and specified services of the major international airports of Auckland, Wellington and Christchurch.

These changes have increased the Commission's scope of responsibility and altered its regulatory role significantly by extending it within sectors. To meet these changes the Commission has developed its plans to implement the framework development necessary to operate the regimes established under Part 4.

Key Dates

The new Part 4 came into effect on 14 October 2008. The previous Part 4A of the Commerce Act remains in effect until 31 March 2009; Part 4 pertaining to the regulation of electricity lines services come into effect on 1 April 2009.

Commission Responsibilities under Part 4

Purpose Statement

Part 4 provides a new regulatory specific purpose statement. The general purpose statement of the Commerce Act does not clearly apply to sectors where there was limited or no competition. The new Part 4 purpose statement addresses this by providing guidance for the regulation of monopoly businesses.

With respect to any activities under Part 4, the Commission seeks to meet the following purpose statement as set out in s 52A:

"The Purpose of this Part is promote the long-term benefit of consumers, by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services -

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

Processes for deciding whether and how to regulate

In addition to the regulated services specifically provided for under the Amendment Act, goods or services in any market may be subject to regulation where:

- there is little or no competition or prospect of competition, and there is substantial scope for the exercise of market power, taking into account the effectiveness of existing regulations or arrangements (including ownership arrangements); and
- the benefits of regulation in meeting the objectives of the purpose statement clearly exceed the costs and risks of regulation.

The Commission may undertake an inquiry on request from the Minister or on its own initiative.

In making recommendations to the Minister whether or not to regulate, the Commission should undertake a qualitative analysis of all material long-term efficiency and distributional considerations. This should involve consideration of the material effects on market efficiency; the material distributional and welfare consequences on suppliers and consumers; and the direct and indirect costs and risks of the various forms of regulation.

Following its inquiry the Commission may then make a recommendation that regulation be imposed. In turn if the recommendation is accepted, regulation is then imposed on goods and services by Order in Council on the recommendation of the Minister of Commerce, in consultation with any relevant sector Minister (such as Energy or Transport).

Any regulation should be the least intrusive necessary to meet the objectives of the purpose statement above. Where competition develops in a market so that the test for whether regulation may be imposed is no longer met, regulation should be removed following an inquiry.

Input Methodologies

In keeping with the need for greater certainty for regulated suppliers and consumers, the Amendment Act requires the Commission to determine binding input methodologies. These are the rules, processes and methods to be used by the Commission and regulated suppliers when defining and setting regulatory mechanisms. The Commission will define

a number of regulatory inputs including how the cost of capital is determined and how assets are valued. Input methodologies, once determined, should improve clarity, certainty and predictability for regulated suppliers, thereby improving investment certainty.

The Commission is required to develop input methodologies for electricity lines services (distribution and transmission), gas pipeline services (distribution and transmission), and specified airport services by 30 June 2010, or up to 6 months later following an extension. The work that will develop sector specific methodologies is highly complex, and involves the application of guidelines and development of rules and processes for the three regulated sectors. It is intended that a number of the methodologies we apply will be applicable across the regulated sectors but in each case it is sector specific methodologies that must be determined and there will likely be in some cases specific differences in applicable methodologies that will be explained in the Commission's decision-making.

The Commission is required to consult with interested parties on whether any amendments should be made to the input methodologies every seven years following the determination of the initial methodologies.

The Commission will consolidate the development and release of any consultation on methodologies, as far as practicable, to address the interrelated nature of the methodologies and to minimise costs to businesses.

Regulatory Mechanisms

The Amendment Act provides for various regulatory mechanisms to be administered by the Commission. These may be applied in any combination following an inquiry or as specified for the regulated sectors.

Information Disclosure

The Amendment Act requires the Commission to administer information disclosure regulation, for the following sectors:

- electricity lines services (transmission and distribution);
- gas pipeline services (transmission and distribution); and
- specified airport services (Auckland, Christchurch and Wellington International Airports).

The Commission is required to set requirements for the information that must be disclosed, the methodologies used in preparing the disclosures and in what form and when the disclosures, must be made. The Amendment Act allows the Commission to monitor compliance, and analyse the disclosed information, and to publicly comment on the disclosed information. Information disclosure regimes aim to promote transparency and when designed well provide incentives for efficient pricing and quality of service that

act as complementary instruments to other regulatory instruments and when applied alone may minimise the necessity for heavier handed forms of regulation.

Default/Customised Price-Quality Regulation

Default/Customised Price-Quality Regulation is designed to build on and replace the previous Part 4A thresholds regime for electricity lines businesses. It is also the form mandated for gas pipeline services. The Commission must set default price quality paths for a specified regulatory period, typically five years.

The Amendment Act prescribes a light-handed approach for setting the default price-quality paths, using readily available information. Suppliers may propose alternative (customised) paths to the default to better meet the business's particular circumstances. The Commission must review and assess the proposals and make a determination within approximately 12 months of receipt. The Commission is only required to assess four proposals per annum. Should the Commission receive more than four proposals in a given year the Act enables the Commission to prioritise these based on the urgency, quality and materiality of the proposals.

Electricity lines service suppliers that are not qualifying consumer-owned businesses⁴, and initially gas pipeline services, other than the controlled distribution pipeline services of Powerco and Vector⁵, are subject to default/customised price-quality regulation. After July 2012, the latter pipeline services will also be covered by this form of regulatory instrument.

Individual Price/Quality Control

Individual Price/Quality Control allows for the Commission to tailor 'supplier specific' price-quality paths, including price control, for particular businesses under certain circumstances.

No sector is currently subject to individual price-quality regulation; however this form may be an option for regulating Transpower following the expiry of its administrative settlement in 2011.

Negotiate/Arbitrate Regime

The Amendment Act provides for a negotiate/arbitrate regime. This mechanism allows the Commission to establish and set the rules for a regime whereby suppliers negotiate

⁴ As noted at footnote 2, Consumer-Owned Businesses not meeting the criteria set out in s 54D will be subject to price-quality default control. Non-consumer owned businesses will similarly, regardless of size, be subject to default/customised price-quality regulation.

⁵ The gas distribution pipeline services of Powerco and Vector (Auckland) are subject to the control authorisations issued under Part 5 of the Commerce Act and will remain subject to the terms of the authorisation until 30 June 2012 unless it is earlier agreed by the Commission that either or both suppliers will be subject to default/customised price-quality control.

prices and supply agreements with their customers, with mandatory arbitration as a backstop should the parties fail to agree price and quality of supply.

The Commission must set terms and limits of any negotiations, and the requirements for the process, form, scope and coverage of any settlement. It is also empowered to appoint an arbitrator if the parties cannot agree on one.

No suppliers are currently subject to a negotiate/arbitrate regime.

Penalties and Appeals

The Amendment Act provides for a range of pecuniary penalties and offences for breaches of the regulatory requirements. It also provides for compensation for breaches of price-quality paths and for injunctions. These provisions replace the Commission's current powers to deal with breaches and remedies for electricity lines businesses that breach thresholds under Part 4A.

Interested parties have a right to appeal any input methodology determinations to the High Court (sitting with lay members). There are separate rights of appeal for customised and individual price-quality path determinations, but such appeals must not include any part of an input methodology.

All determinations made by the Commission are subject to judicial review.

Airports

Auckland, Wellington, and Christchurch International Airports have strong natural monopoly characteristics, and specified airport services are currently subject to information disclosure under the Airport Authorities (Airport Companies Information Disclosure) Regulations 1999.

The Part 4 of the Commerce Act now provides for an information disclosure regime for these services to be administered by the Commission. No other form of regulation is to apply to these airport services at present.

The Commission is required to make a determination setting out information disclosure requirements by 1 July 2010. This determination must also specify any input methodologies that apply. Information disclosure regimes aim to promote transparency and when designed well provide incentives for efficient price and quality of service that may minimise the necessity for heavier handed forms of regulation.

Part 4 also requires the Commission to report to the Minister as soon as practicable after the start of the next pricing period in 2012 on the effectiveness of the information disclosure regime. This review must be held in light of the purpose statement set out in s 52A and must include consultation with interested parties.

Transitional Provisions

The Airport Authorities (Airport Companies Information Disclosure) Regulations 1999 will continue to apply until the new requirements are made. Suppliers must supply a copy of disclosures made under those regulations, which the Commission may monitor and analyse.

VOTE ENERGY

The Commission has responsibility for regulating the supply of electricity and gas distribution and transmission services under Part 4 of the Commerce Act.⁶

This section gives an overview of the regulatory regimes for electricity and gas sectors.

Electricity Distribution

The Commerce Act gives the Commission responsibilities for the regulation of 29 electricity distribution businesses.

Information Disclosure

In March 2004 the Commission first published Electricity Information Disclosure Requirements. Information disclosure is a complementary regime that is designed to ensure that sufficient information is readily available to interested parties. A well-designed information disclosure regime provides incentives for regulated businesses to provide efficient prices and efficient quality service that reflects consumer demands. The March 2004 Electricity Information Disclosure Requirements were largely adopted from the previous Regulations administered by MED. A comprehensive review of these requirements was then carried out by the Commission in consultation with interested parties and revised requirements were issued in October 2008. These updated requirements are the currently applicable information disclosure mechanism for electricity distribution businesses. The requirements will continue to apply under the previous legislation until the Commission makes a determination setting out how information disclosure applies under the Commerce Amendment Act.⁷ The Commission is required to make this determination as soon as practicable after 1 April 2009.

⁶ In addition, the electricity and gas industry sectors are subject to general regulation under both the Commerce and Fair Trading Acts. The Commission also enforces the Electricity Industry Reform Act.

⁷ s 54I(1) of the Commerce Amendment Act.

Price / Quality Regulation

Current Arrangements

Part 4A of the Commerce Act provides for a targeted control regime for electricity lines businesses. The Commission is required to set price path and quality thresholds that regulated businesses should not breach. Following a breach of a threshold by a lines business, the Commission may investigate the lines business's performance further under a post-breach inquiry. Where so determined, the Commission may then impose control under Part 5. The following paragraphs briefly describe the current thresholds.

Price Path Threshold

The Commission's current price path threshold employs the 'CPI minus X' form of incentive-based regulation, commonly used in overseas jurisdictions.⁸ Prices must stay within a band linked to the Consumer Price Index (CPI), less an 'efficiency factor', X. Under CPI-X, changes in price or revenues of controlled goods or services are linked to the increase in general economy prices, using CPI as a proxy. The X factor is determined by the Commerce Commission to reflect anticipated efficiency gains or productivity growth.

Quality Threshold

The Commission's current quality threshold is designed to ensure adequate quality performance amongst businesses regulated under the price-path. Regulated businesses whose revenue is restricted under price control may, without a quality threshold, have an incentive to reduce performance standards (e.g. though reduced maintenance) in order to maintain profit levels. The imposition of a quality threshold seeks to ensure a mandated minimum level of performance. Assessment of electricity distribution performance in New Zealand is based on supply reliability focussing on the duration and frequency of service interruptions.

Transitional Arrangements

The current threshold mechanism applies until Part 4A expires on 31 March 2009. Provisions under the Commerce Amendment Act (2008) applying to electricity distribution come into effect on 1 April 2009. The existing thresholds are then deemed to be default price/quality paths for a one-year period commencing 1 April 2009. However, they will continue to apply only to non-consumer owned and non-qualifying consumer-owned businesses⁹. Breaches will continue to be assessed as threshold breaches¹⁰.

⁸ Also referred to in some jurisdictions as RPI-X regulation. This incentive mechanism was developed by Stephen Littlechild in the United Kingdom. RPI refers to the Retail Price Index measure used in the UK and other jurisdictions.

⁹ Consumer-owned businesses not meeting the criteria set out in s.54D will be subject to price-quality default control. Non-consumer owned businesses will similarly, regardless of size, be subject to default/customised price-quality regulation.

¹⁰ The breach must be dealt with in accordance s54N and not under Part 6.

The recent sale of the Wellington distribution network by Vector Limited has resulted in an additional distribution business entering the sector. Being investor-owned, this business does not meet the criteria for consumer-ownership and will be subject to regulation under the transitional arrangements.

Administrative settlements for distribution businesses that are accepted before 1 April 2009 are not limited or affected by the Amendment Act and breaches must be dealt with in accordance with the terms of settlement.

Prior to the expiration of the transitional arrangements, the Commission will engage in consultation with interested parties to set default price-quality paths to take effect on 1 April 2010.

Future Arrangements

Default/customised price-quality control regulation, replaces the Part 4A targeted-control thresholds regime and takes effect on 1 April 2010 for relevant distribution businesses.¹¹ Breaches of default/customised price-quality regulation will be dealt with under Part 6 of the Commerce Act which provides for pecuniary penalties, injunctions and offences.

Default Price–Quality paths

All non consumer-owned and non-qualifying consumer-owned distribution businesses are initially subject to default price-quality regulation. Default price-quality control will be reset by stating the starting prices that apply to the services supplied being based on prices that applied at the end of the preceding regulatory period or prices determined by the Commission, based on the current and projected profitability of each supplier; the rate of change in prices, relative to the consumer price index based on the long-run average productivity improvement rate achieved by suppliers in NZ and/or comparative suppliers in comparable countries. Alternate rates can be set for specific suppliers if in the Commission's opinion there is unnecessary or undue hardship to the supplier to minimise price shock to consumers; or as an incentive for a supplier to improve its quality of supply.

Customised Price–Quality Paths

Suppliers may submit a proposal for a customised price-quality path based on their particular circumstances and their view of whether the default path appropriately meets those circumstances. The Commission will assess any proposal and determine whether a customised price-quality path is more appropriate, and if so, specify the price-quality path that should apply. The Commission may determine any customised price path it considers appropriate and without limitation, it may set a customised price path that is lower, or otherwise less favourable than the default price-quality path and may claw back the difference from the regulated supplier.

¹¹ Consumer-owned businesses not meeting the criteria set out in s.54D will be subject to price-quality default control. Non-consumer owned businesses will similarly, regardless of size, be subject to default/customised price-quality regulation.

In receiving the proposals, the Commission is not required to consider any more than 4 proposals for a customised price-quality path in any one year. Should more than 4 proposals be received the Commission must prioritise its consideration of the proposals based on the urgency, quality and materiality of the proposals.

Electricity Transmission

Information Disclosure

The review of Transpower's information disclosure requirements was held over while the Commission completed a post-breach inquiry into Transpower under Part 4A, and negotiated an administrative settlement with Transpower. The Commission has recently amended the information disclosure requirements to incorporate terms agreed to in the administrative settlement¹², and has yet to further consider the information disclosure requirements as they relate to Transpower. Information disclosure requirements that apply specifically to Transpower under Part 4 as established by the Commerce Amendment Act will be determined. These will be put into place as soon as practicable after the determination of relevant binding input methodologies applicable to electricity transmission.

Price / Quality Regulation

Administrative Settlement

As noted above, the Commission completed a post-breach inquiry into Transpower under Part 4A and negotiated an administrative settlement and new thresholds with Transpower. The new thresholds took effect from 1 July 2008 and continue through to 30 June 2011. Prior to the end of the regulatory period the Commission will recommend to the Minister of Commerce a new regulatory instrument for the supply of transmission services.

Transpower recently sought a change to the settlement agreement to remove its exposure to instantaneous reserve fees. Transpower proposed that the settlement agreement be amended to allow instantaneous reserve fees to be treated as pass-through costs. The Commission's draft decision, subject to consultation, is not to accept Transpower's proposed amendment. A final decision is expected before Christmas 2008.

Transitional and Future Arrangements

Under the Commerce Amendment Act, Transpower continues to be subject to its administrative settlement until at least 30 June 2011 after which Transpower will transition into the new legislative framework provided by the Commerce Amendment Act. In the interim the Commission will make a recommendation, following consultation with interested parties, on what price-quality regulation should apply.

¹² Transpower, *Formal Settlement Proposal*, 11 April 2008 (Amended 12 May 2008) and Commerce Commission, *Decision and Reasons for Not Declaring Control of Transpower New Zealand Limited & Decision to Reset Transpower's Thresholds*, 13 May 2008.

Role of the Commerce Commission and the Electricity Commission

The Commerce Commission and the Electricity Commission each have specific but different responsibilities for regulation of electricity markets. To manage any residual risk of overlap the two Commissions, operate a Memorandum of Understanding. To further assist this coordination, the Electricity Commissioner is an Associate Member of the Commerce Commission.

The Commerce Commission administers competition law and the economic regulation of electricity lines businesses, including Transpower, the electricity transmission business. The Commerce Commission is concerned to ensure that any investment is efficiently recovered.

The Electricity Commission oversees electricity governance matters including aspects of the regulation of Transpower relating to transmission risk management, investment in and maintenance of the transmission network.

The Memorandum of Understanding includes a protocol for transmission related issues which ensures operational coordination in areas such as price and quality of service. A further protocol on improving incentives for electricity lines businesses in respect of managing distribution losses; facilitating uptake of advanced metering infrastructure and more efficient distribution pricing; ensuring target security levels for distribution networks are met at least cost; and facilitating investment in energy efficiency (including consumer end-use efficiency), demand side management and distributed generation was approved by the Board of the Electricity Commission on 12 November 2008 and the Electricity Division of the Commerce Commission on 13 November 2008. The MOU and protocols were executed by the Electricity Commissioner and the Chair of the Commerce Commission on 13 November 2008.

Gas Distribution and Transmission

Information Disclosure

Gas pipeline services (both transmission and distribution) are currently subject to information disclosure requirements enacted under the Gas (Information Disclosure) Regulations 1997, administered by the Ministry of Economic Development. These will continue to apply until the Commission makes a determination setting out how information disclosure applies. The Commission is required to make this determination as soon as practicable. Information disclosure regulation provides a complementary regulatory regime to default/customised price-quality control and is designed to ensure that sufficient information is readily available to interested persons to assess the performance of the regulated supplier.

Price / Quality Regulation

Control of Vector and Powerco Distribution Services

Two gas businesses are currently directly subject to price/quality regulation – these are the gas distribution pipelines businesses of Powerco and Vector’s Auckland distribution

network. In April 2003 the Minister of Energy, in response to the public policy concern that gas consumers were being overcharged and that gas pipelines suppliers were abusing their market power, requested a Part 4 Inquiry and sought recommendations as to whether any suppliers should have their prices, revenues and/or quality controlled under Part 5 of the Commerce Act.

In the Inquiry, the Commission found that Powerco and Vector had been earning significant excess returns and that control would likely result in considerable reductions in gas distribution prices (on average) to consumers. A recommendation of control of the gas distribution services of Powerco and Vector (Auckland) was delivered to the Minister of Energy in November 2004.

On 27 July the Minister of Energy announced a decision to declare control over the recommended gas distribution services. An Order in Council took effect 25 August 2005, enabling the Commission to directly control the services under Part 5 of the Commerce Act. The Commission issued a Provisional Authorisation in respect of the controlled services in August 2005. The Provisional Authorisations reduced prices on average by 9% for Powerco and 9.5% for Vector. The reductions took effect from 1 October 2005. Since those reductions were imposed prices had been held constant in nominal terms. Real price reductions have been approximately 19% for each business.

The Final Authorisations on the control of the gas distribution services of Powerco and Vector (Auckland) were announced by the Commission on 31 October 2008, following extensive public consultation on a wide range of relevant issues. In establishing the Final Authorisations the Commission required further average price reductions of 11.1% for Powerco and 3.7% for Vector. Prices will be held constant in nominal terms for the regulatory control period to 1 July 2012. Total price cuts of 30% on average for Powerco and 22% on average for Vector will be achieved when combined with the price reductions that took effect from 1 October 2005. The price reductions imposed still ensure appropriate investment incentives so that consumers receive safe and reliable gas supply.

A key aspect is the provision of commercially realistic rates of return on capital. The Commission considered the provision of such returns across a number of regulatory jurisdictions and took account of current economic conditions and the impact on the cost of raising and servicing debt. The Commission decided to allow a post-tax weighted average Cost of Capital of 9.59 percent per annum which is higher than all comparable allowances currently proposed by regulators in Australia and the United Kingdom.

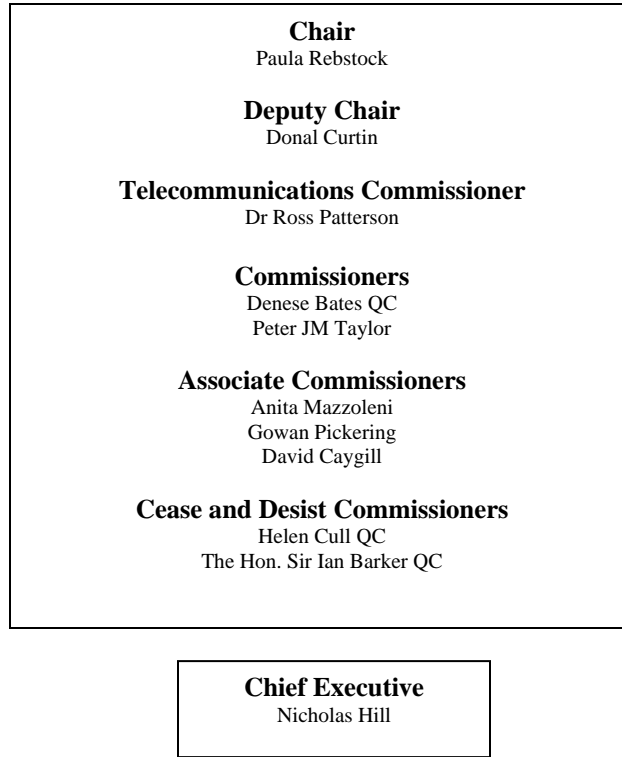
Transitional and Future Arrangements

Under transitional arrangements the final determination for control will apply through to 30 June 2012, or such other earlier timeframe as is agreed by the Commission. These services will then transition to default/customised price-quality regulation.

In addition, all gas pipeline services (except those explicitly exempted by the legislation) are subject to default/customised price-quality regulation. This mechanism will be similar to that for electricity distribution businesses.

APPENDIX 1

Structure of the Commerce Commission



Networks Branch <i>Director</i> Michael Clark	Competition Branch <i>Director</i> Deborah Battell	Legal Service Branch <i>General Counsel</i> Peter R Taylor	Fair Trading Branch <i>Director</i> Adrian Sparrow	Corporate Services Branch <i>Director</i> Glen Maguren	Economic Services Branch <i>Chief Economist</i> Michael Pickford
<ul style="list-style-type: none"> • Network Performance Group • Electricity Lines • Gas Pipelines • Airports • Input Methodologies 	<ul style="list-style-type: none"> • Market Behaviour Group • Market Structure Group • Competition Policy and development 	<ul style="list-style-type: none"> • Enforcement Group • Regulatory Group • Legal Support 	<ul style="list-style-type: none"> • National office • Auckland • Wellington • Christchurch 	<ul style="list-style-type: none"> • Communications • Finance • Human Resources • Information • Technology 	<ul style="list-style-type: none"> • Competition and Fair Trading Group • Network Industries Group

APPENDIX 2

Commerce Commission Members

Paula Rebstock –Chair

Paula Rebstock was appointed an Associate Commissioner in 1998, then Commissioner and Deputy Chair before she was appointed Chair in December 2003. An economic consultant and company director, Paula has a BSc (Economics) from the University of Oregon and an MSc (Economics) from the London School of Economics, and has completed further post-graduate studies at the Kiel Institute of World Economics. Paula has been an economic adviser with the Department of the Prime Minister and Cabinet, and General Manager Policy with the Department of Labour. She chairs a private sector company and is a member of the University of Auckland Business School Advisory Board and of the Synergia Advisory Board.

Donal Curtin – Deputy Chair

Donal Curtin was appointed an Associate Commissioner in 2001, then Commissioner. He was reappointed for a further three years in 2005, and appointed Deputy Chair in July 2008. Donal is a business economist with wide experience of applying economics to commercial decisions. He has been the Bank of New Zealand's chief economist and head of its national private banking unit. He currently advises on monetary policy to Parliament's Finance and Expenditure Select Committee, is Chair of the Public Trust, and is a director or adviser to a number of private companies.

** Donal Curtin stood aside from his duties as Deputy Chair in September 2008 while an independent inquiry is conducted into the extent of disclosure of potential conflicts of interest.*

Denese Bates QC – Commissioner

Initially appointed in 2001, Denese Bates was reappointed in April 2004 for a period of five years. 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.

Peter JM Taylor – Commissioner

Peter Taylor was appointed in February 2001 for five years and reappointed for a further four years in February 2006. A retired chartered accountant with experience in Africa, the United Kingdom, Australia and Asia, Peter was a consulting partner of a major New Zealand accountancy business for 14 years. During this time he managed the company's Wellington office and was a director for six years. From 1994 to 1996 he was seconded to the Crown Company Monitoring and Advisory Unit as its Chief Executive. He is Deputy Chair of New Zealand Venture Investment Fund Limited and director of a number of private companies.

Dr Ross Patterson – Telecommunications Commissioner

Dr Ross Patterson was appointed Telecommunications Commissioner in July 2007 for a period of five years. Ross has a PhD in competition law. He has practised extensively in New Zealand and Australia, specialising in competition and regulatory law, most recently as head of Minter Ellison's competition and regulatory practice in Australia.

**Dr Ross Patterson is on leave from the Commission until January 2009 to seek health treatment.*

Anita Mazzoleni – Associate Commissioner

Anita Mazzoleni was appointed in May 2005 and reappointed in May 2008 for four years. Anita is an independent corporate finance adviser. She has a BCom and LLB from Auckland University and is a chartered accountant and solicitor. Anita has had a commercial career in industry and finance, particularly the evaluation and funding of infrastructure. She has previously held senior positions in the public and private sector, including as General Counsel at Contact Energy, director of Deloitte Corporate Finance and general Manager at Citibank, and was recently a director of Industrial Research Limited.

Gowan Pickering – Associate Commissioner

Gowan Pickering was appointed in May 2005 and reappointed in 2008 for a further four years. Gowan spent more than 30 years with IBM, where he was IBM New Zealand Chief Executive Officer and Chairman from 1991 to 1998. He was Chief Executive for the Foundation for Research, Science & Technology for four years from 2000. He is currently a member of the Council of Victoria University of Wellington and a director of a number of technology companies.

David Caygill – Associate Commissioner

David Caygill was appointed Deputy Chair in December 2003 for a term of five years. David is a solicitor and a former Minister of the Crown. On his retirement from Parliament David joined Buddle Findlay. His governance experience includes Chair of the Grid Security Committee, the Electricity Governance Establishment Group and the Accident Compensation Corporation. He has also been a member of the State Services Commission's Crown Entities Review Panel and the Review of the Centre Advisory Group. David resigned from the Commission in September 2007 to take up the role of Chair of the Electricity Commission. He was subsequently reappointed to the Commerce Commission as an Associate Member.

The Honourable Sir Ian Barker QC – Cease and Desist Commissioner

The Honourable Sir Ian Barker QC was appointed in October 2007 for five years. He retired as a Senior Judge of the High Court of New Zealand in May 1997 after 21 years of service on the Bench, including 11 years as Judge-in-Charge of the Commercial List. He is a past President of the New Zealand Arbitrators' and Mediators' Institute, a member of arbitration panels in several Pacific Rim arbitration centres, has chaired several arbitral

tribunals for the International Chamber of Commerce's Court of Arbitration in Paris, and serves on several Pacific Courts of Appeal.

Helen Cull QC – Cease and Desist Commissioner

Helen Cull QC was appointed in October 2007 for five years. She has extensive experience in a range of litigation and in public law. She has chaired several national inquiries including the State Services Commission Scampi Inquiry, the G Parry Inquiry, Mental Health inquiries, the Chest Physiotherapy Inquiry and the Fire Service Inquiry. She has served as a company director and board member of several statutory bodies. Helen is currently a director of Solid Energy New Zealand, Senior Advisory District Inspector of Mental Health, and a member of the New Zealand Law Society Ethics Committee.

APPENDIX 3

Overview of Major Litigation

Some of the cases currently being taken by the Commission are set out below to illustrate the types of issues confronting the Commission. In addition, the Commission is taking major litigation involving cartels, Fair Trading and CCCFA issues, including, for example under the Fair Trading Act, the Commission's case to seek redress for consumers affected by Carter Holt Harvey's misleading conduct over graded timber.

Interchange Fees

The Commission filed proceedings alleging that various members of the Visa and Mastercard schemes breached the Commerce Act by fixing, or being parties to fixing, the level of interchange fees. The interchange fees forms a major component of the merchant service fees charged by banks to merchants for processing credit card transactions in the merchant acquiring market. The Commission alleges that fixing the interchange fees is anti-competitive, because associated rules prevent retailers from negotiating the merchant service fees, or charging credit card users extra to cover them. The Commission also considers that there is inadequate transparency about the fees, as consumers are unaware of the flow-on impact the fees have on all prices, regardless of method of payment. A court date has yet to be set for the proceedings. Transactions on New Zealand Visa cards and MasterCard cards totalled \$19 billion in 2004, with 2.1 million Visa cards and 900,000 MasterCard cards in use. In terms of volume of commerce affected, this action is the largest the Commission has ever initiated.

Some countries have regulated a solution for similar matters in their jurisdictions. One of the issues raised by the card issuers is that the fees scheme is necessary for the successful operation of the credit cards. The issuers could have applied for authorisation for the scheme but have chosen not to do so.

Waikato Pathology

A further two investigations were completed into behaviour in pathology markets. The first involved an investigation into market sharing in the Waikato District Health Board (DHB) region. The Commission considered that New Zealand Diagnostic Group Limited entered into an arrangement with Pathology Associates Limited (with whom it was in merger negotiations) whereby they would not compete to win customers from each other, and would advise each other when clients were interested in switching.

Following this arrangement, the pathology companies agreed with the Waikato DHB to a 'moratorium on competition'. The DHB's behaviour was purportedly driven by concerns that competition via specimen collection fee payments was inappropriately incentivising General Practitioners (GPs) to request unnecessary pathology tests. The DHB's laboratory had recently entered the market as a competitor and was also engaging in this behaviour.

The ‘moratorium’ saw the DHB’s hospital laboratory freezing its expansion into the community pathology market and the two private providers agreeing not to compete by any method to win new clients. The moratorium effectively removed *all* competition from the market, including that for the legitimate reimbursement of specimen collection costs, as well as competition for improved service and quality. The investigation identified several examples of GPs being prevented from acquiring alternative pathology services from a competing provider as a consequence of the moratorium.

The Commission is concerned that, despite the recent successful prosecutions of ophthalmologists, potential health sector breaches of the Act continue. Proceedings have been issued against Pathology Associates Ltd and New Zealand Diagnostic Group, as a result of the investigation, with the aim to reinforce the benefits of competition to the health sector.

Visy

The Commission issued proceedings against Visy Australia and Visy New Zealand as well as four executives for collusive activities in the corrugated cardboard market. Visy is alleged to have colluded with Amcor Ltd with regard to the tendering and pricing of the supply of corrugated cardboard boxes to large trans-Tasman accounts and New Zealand accounts. Corrugated fibre packaging is widely used by both domestic and export business and the market is estimated to be worth \$446 million in 2003/04. This alleged activity had the potential to cause significant harm to the economy and efficiency of New Zealand producers and manufacturers. Visy has pleaded guilty to similar behaviour in the Australian market and been fined \$36 million.

This cartel investigation took almost three years and included the use of search warrants and multiple interviews with the same people. Many of the interviews were conducted in Australia. This level of investigative activity is indicative of the nature of the larger scale cartel investigations which the Commission is currently undertaking, where, even with a leniency applicant, behaviour is covert and investigative activity is complex.

Telecom 0867

The Commission alleged Telecom contravened s 36 of the Commerce Act, when it introduced its 0867 package in 1999.. This matter was considered under the previous dominance test. The High Court found that Telecom did not use its dominant position or have an anti-competitive purpose when it introduced the 0867 package, so did not contravene s 36.

The Commission has appealed the 0867 judgment. The Court found that Telecom did not use its dominance in the retail residential phone services market when it introduced the 0867 scheme. This finding was based on the Court’s discussion of a counterfactual world in which Telecom is non-dominant in the market. The Court concluded that, in such a world, Telecom would still have introduced the 0867 scheme. In particular, the

Commission has appealed the Court's determination of the counterfactual in which Telecom is non-dominant in a market, in which competition in the future will be highly unlikely.

Further, as the Court determined that Telecom was non-dominant in the market, it did not turn its mind to Telecom's use of dominance in that market. The Court's finding of non-dominance in the wholesale market has greater implications for Telecom's market conduct generally and more broadly for other New Zealand corporations generally considered to have substantial market power.

Telecom – Datatails

In March 2004, the Commission brought proceedings against Telecom alleging that Telecom misused its market power, and at the time continued to do so, to prevent or deter competition in markets involving high speed data transmission.

The Commission alleges that Telecom introduced new pricing for its retail high-speed data transmission services in early 1998 and in March 1999 introduced new wholesale pricing.

Telecom provides other telecommunication service providers competing with Telecom two wholesale data service options:

- the ability to resell Telecom's retail high-speed data transmission services; and
- access to dedicated Datatails in Telecom's network in order to provide retail high-speed data transmission services.

The Commission alleges that in almost all circumstances, the price charged by Telecom for access to Datatails 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 Datatails; and
- the sum of Telecom's direct incremental cost and opportunity cost of supplying access to the Datatails.

The alleged effect is to block competition in the provision of high speed data services. The Commission currently awaits judgment.