



COMMERCE COMMISSION

**BRIEFING FOR
INCOMING MINISTER**

DECEMBER 2011

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Purpose

1. The purpose of this briefing is to give you an overview of the Commerce Commission (Commission) highlighting our main areas of focus and emerging issues. More information is provided about the Commission in our 2011-14 Statement of Intent and the briefing should be seen as supplementary to separate briefings from the Ministry of Economic Development (for Vote Commerce and Vote Telecommunications) and other regulatory agencies such as the Electricity Authority and the Financial Markets Authority.
2. The briefing begins with an introduction from Dr Mark Berry, the Chair of the Commission. The introduction summarises the role and function of the Commission and highlights emerging issues. The bulk of the briefing is structured around our work in relation to ensuring that 'markets are more competitive and consumers are better informed' and 'regulation is better targeted and more effective'. For each of these broad areas the briefing gives an overview of the Commission's goals, our role and functions, and the work programme over the short to medium term. The briefing also includes further detail on key and/or emerging issues that we would like to bring to your attention as the responsible Minister. The final section of the briefing presents organisational information about the Commission including our structure, resourcing and key relationships.
3. The briefing also provides the Commission with an initial opportunity to establish how to engage with you as Minister. While the Commission is an independent agency it operates a 'no surprises' approach with its Minister. We are happy to work with you to agree the content of subsequent briefings and their frequency.

Introduction from the Chair

4. The Commission is New Zealand's competition authority and economic regulator. We are an Independent Crown Entity established in 1986 under the Commerce Act. The Commission is responsible for enforcing laws relating to competition, fair trading, and consumer credit contract laws, and have regulatory responsibilities in the electricity lines, gas pipelines, telecommunications, dairy and airport sectors.
5. New Zealanders benefit from the work of the Commission. We work to ensure that markets are competitive and well regulated for the long term benefit of all New Zealanders. Competition contributes to the economic performance and welfare of New Zealand as a whole. Where competition is weak or absent, regulation may facilitate increased competition or, if that is not possible, mimic the outcomes that would be achieved if there was effective competition (ie competitive prices and quality of service).
6. Our overall aim is to achieve the best possible outcomes in competitive and regulated markets for the long term benefits of New Zealanders. To achieve this goal we focus on two broad outcome areas:
 - 6.1 Markets are more competitive and consumers are better informed
 - 6.2 Regulation is better targeted and more effective.

Markets are more competitive and consumers are better informed

7. We enforce, adjudicate and provide information and guidance relating to New Zealand's competition law, the Commerce Act 1986 (Commerce Act). We also enforce two pieces of consumer legislation that promote fair competition and help consumers be confident that they get accurate information when buying goods or services. These pieces of legislation are the Fair Trading Act 1986 (FT Act) and Credit Contracts and Consumer Finance Act 2003 (CCCF Act).
8. Our role involves addressing anticompetitive behaviour and helping businesses provide accurate information to consumers. Traditionally this has involved enforcing breaches of the legislation we administer. Litigation is an important part of our enforcement approach, and the Commission has had considerable success in addressing a number of long standing cases involving non-compliance.
9. In the past year we have shifted our focus to helping business comply with competition and consumer law. By placing greater emphasis on helping businesses to understand what they need to do to comply with competition and consumer legislation, the Commission aims to lift voluntary compliance. This influencing role involves the use of targeted education initiatives such as published guidelines and presentations, which we believe over time, will reduce the need for costly litigation.

Regulation is better targeted and more effective

10. The other key platform of our work involves the use of effective and well targeted regulation. Where competition is not possible or is limited, regulation aims to provide consumers with the benefits that that competition would provide. Our work in this area involves developing and implementing the regulatory regime under Part 4 of the Commerce Act (Part 4), and responsibilities under the Telecommunications Act 2001 (Telecommunications Act) and Dairy Industry Restructuring Act 2001 (DIR Act).
11. Part 4 is a relatively new part of the Commerce Act that provides for the regulation of industries where there is no competition or little or no likelihood of effective competition. Businesses currently regulated under Part 4 include suppliers of electricity lines, gas pipelines and specified airport services (such as aircraft and freight activities, airfield activities and specified passenger terminal activities).
12. Key components of our Part 4 work include setting price-quality paths (where required), monitoring the performance of regulated services (through information disclosure), and ensuring compliance with regulatory requirements. This work builds on the release of five input methodologies determinations for electricity lines, gas pipelines and specified airport services in December 2010. We also aim to lift voluntary compliance with regulatory requirements by engaging constructively with regulated businesses. Where this is not suitable we can take enforcement action to ensure regulated businesses comply.
13. The Part 4 regime is complex and involves a number of different components. While the Commission has made steady progress implementing the regime over the last two years, all of the components are not yet in place. The Part 4 regime has a cyclic element to its structure in that there are periodic increases in the work associated with resetting price-quality paths and ongoing compliance assessments. At the moment the regime has not yet had the opportunity to work through the full regulatory cycle and it is too early to judge its full effectiveness.
14. The other focus of regulatory activity is the Telecommunications Act which regulates the supply of telecommunications services in New Zealand. This is administered by the Office of the Telecommunications Commissioner within the Commerce Commission. The Telecommunications Act requires us to make determinations in respect of designated access and specified services and to undertake costing, monitoring and enforcement activities.
15. One of the functions is to review competitive conditions in telecommunications markets and, in areas where competition is effective we remove regulation.
16. The creation of the rural broadband infrastructure and the ultra fast broadband (UFB) network and its associated activities is an important development in New Zealand's telecommunications sector. In 2011/12, work will continue on building the UFB network by selected local fibre companies. We will work closely with the local fibre companies and other stakeholders to implement the regulatory regime required to support this initiative.

Emerging issues

17. Currently a number of issues influence our effectiveness in ensuring that markets are well regulated, and addressing breaches of competition and consumer legislation. These issues are varied and involve the operational implications of legislative change and the impact of recent court judgments on the way the Commission carries out its work and interprets the legislation it administers. The main issues are highlighted below.

Section 36 of the Commerce Act

18. Section 36 of the Commerce Act involves anticompetitive conduct by single firms. A recent Supreme Court case has introduced uncertainty in how to practically apply the legal tests involved and risks putting the Commission out of alignment with similar legislation in Australia. We consider this uncertainty would be most efficiently addressed through legislative amendment. Clarity of this issue will help the Commission address anticompetitive behaviour more effectively and ensure competitive markets exist for both business and consumers. Maintaining competitive markets in this way is important to ensure economic growth and productivity over the long term.

Commerce (Cartels and Other Matters) Amendment Bill

19. This Bill will introduce the option of criminal sanctions for hard-core cartel behaviour (eg price-fixing, bid-rigging, market sharing). The Bill also introduces a new “collaborative activity” defence and proposes a clearance regime for “collaborative activities”. [Withheld under section 9(2)(g)(i) of the Official Information Act 1982]

Potential amendments to CCCF Act

20. There are two main emerging issues in relation to the CCCF Act. The first involves a recommendation to Cabinet from the Minister of Consumer Affairs (MCA) that consideration be given to amending the CCCF Act, including which organisation should undertake enforcement responsibilities. The second involves the removal of responsibility under the FT Act for enforcing misleading conduct relating to financial products and services. The Financial Markets Conduct Bill effectively removes this responsibility from the Commission and proposes that it will rest with the Financial Markets Authority.
21. If a policy decision is made to transfer responsibility for CCCF Act and FT Act (financial services) enforcement to the FMA, there will be a number of transition issues involving the status of current litigation, administration of investigations and the general impact on staff working in the CCCF Act area. The Commission will assist MCA with the review of the CCCF Act.

Potential amendments to FT Act (Consumer Law Review)

22. The Consumer Law Reform Bill currently before Parliament proposes an enhanced FT Act with some new powers. While the FT Act provides solid protection for consumers presently, in the Commission’s view it does not go far enough and is lagging behind

policy developments in similar areas. There is scope for it to be improved, modernised and made consistent with other important consumer protection legislation in New Zealand and Australia.

23. There are a number of important provisions in the Australian Consumer Law, the CCCF Act and the proposed Financial Markets Conduct Bill that are not included in the FT Act or in the Consumer Law Reform Bill before Parliament. Those provisions include civil penalties and higher criminal penalties, compulsory interview powers and all-inclusive pricing. These additional powers and abilities would allow the Commission to respond more efficiently and effectively to non-compliance.

Part 4 of the Commerce Act

24. The Commission is currently involved in substantial litigation relating to its input methodology determinations. While these reviews were anticipated, the complex nature of the proceedings will result in slowing the delivery of the Part 4 regime and downstream benefits for suppliers and consumers.
25. To some extent the complexity and cost of this litigation has been driven by legislative ambiguity. Some constrained legislative amendments to clarify the policy intent of Parliament could ensure that the policy outcomes sought under Part 4 are achieved more efficiently, and significant cost savings are made by avoiding further potential litigation.
26. One recent judgment, in particular, where substantial legislative ambiguity was at issue, has had a significant impact on the Commission's regulatory work programme.
27. The judgment by Clifford J in the High Court has required, among other things, that we develop additional input methodologies relating to starting price adjustments under default price-quality paths. These input methodologies are additional to those completed in December 2011. The Commission suspended its processes for amending starting price adjustments for electricity distribution businesses in light of this judgment.
28. The electricity distribution price changes were due to be announced in October 2011, but will now be announced in November 2012.
29. We have appealed this decision as a matter of urgency. We do not believe that an input methodology for starting prices was intended when Part 4 of the Commerce Act was enacted. We are also concerned that the reasoning in the High Court's decision could potentially lead to the Commission being required to develop other process input methodologies that we do not believe were intended by Parliament.
30. Despite this appeal, we have begun work on the development of the additional input methodologies to ensure that legal processes do not further delay the pricing adjustments. This work was unanticipated and has additional cost for us in the 2011/12 and 2012/13 financial years. We will be looking to reprioritise our work programme to manage this issue and will not be seeking additional funding.

31. We also note the recent judgment in the Supreme Court relating to the amounts recoverable by Telecom for the net cost of meeting its telecommunications service obligations (TSO) to commercially non-viable customers. The judgment has some relevance to the Part 4 work. The TSO judgment provides specific commentary on how to value the capital cost to an “efficient service provider” of providing the regulated service. This commentary may well be relevant to the merits of the asset valuation input methodologies under Part 4 of the Commerce Act, despite the fact that the TSO decision relates to matters under the Telecommunications Act. We are considering this issue further.

Telecommunications (TSO, Broadband and Other Matters) Amendment Act

32. The passing of this legislation and the structural changes it involves have implications for both the regulatory regime and structure of the industry as a whole. While the Commission has completed much of the development of the initial frameworks it will take some time for these frameworks to ‘bed in’, and for the industry to accustom itself to the structural changes that have occurred due to regulatory change and new technology. The changes will continue over the next few years and it is essential that the lessons learned from the past (including from the 2011 regime) are identified and taken into account in these reviews, ensuring that competition is enhanced.

Implications of TSO decision

33. The Supreme Court has recently held that the Commission's TSO methodology for the 2004/05 and 2005/06 years over-valued Telecom's assets for the purposes of the TSO calculation. We are currently working through how we can most efficiently respond to that judgment in a context where legislative change has made this methodology of historical relevance only.

Value for money

34. In carrying out our work the Commission continues to look for ways to operate more efficiently and effectively by focusing on the benefits of our work to the wider economy. We carefully monitor our work programme to anticipate any significant pressures on our operating budget, and manage our costs within current appropriation levels. The Commission is also prudent in the way it manages its financial risks. We have built up reserves through a combination of a downturn in merger activity, restructuring the organisation and streamlining of processes over the last few years.
35. These reserves allow the Commission to mitigate its risks around litigation in the event of adverse legal judgments. However, the Commission faces a significant litigation workload over the next two years, which will likely require us to draw on reserves. We may also need to seek approval for fiscally neutral expense transfers to manage the changed phasing of litigation expenditure over this period.
36. While many of the changes that we have made in the way we go about our substantive work have been aimed at increasing efficiency and thereby reducing financial pressure on the organisation, we also continue to focus on carefully

managing our 'back office' costs. Examples include a reduction in direct salary costs across the organisation in 2010/11 of more than \$1 million, and a reduction in accommodation costs.

Markets are more competitive and consumers are better informed

37. Competition is important to New Zealand because it lays a foundation for economic growth and productivity for both businesses and consumers. Businesses and consumers benefit when markets work well because a competitive environment encourages innovation and investment by business and results in efficient prices, quality, and greater choice for consumers.
38. The Commission promotes competition by administering and enforcing New Zealand's competition and consumer legislation. We promote competitive markets by ensuring businesses do not undertake mergers or trade practices that lessen competition. By ensuring that businesses represent goods and services accurately, we help traders to compete on the merits of their products, and consumers to make better informed purchasing decisions.

Markets are more competitive

Purpose/context

39. To ensure that markets are more competitive, the Commission enforces, adjudicates and provides information and guidance relating to New Zealand's competition law, the Commerce Act. The Commerce Act is a set of generic competition provisions that regulate anti-competitive market behaviour or structures in any market. It prohibits mergers and acquisitions that substantially lessen competition. Anti-competitive behaviour and structures may be authorised if the overall public benefits outweigh the competitive harm.
40. The Commission's approach to enforcement involves using a wide range of tools aimed at ensuring that markets are more competitive and that compliance levels improve over time. Specific elements of our enforcement work include the following:

Our approach	Explanation
Investigations and litigation	Addressing a variety of behaviours that can limit competition; including business acquisitions, cartel and other coordinated behaviour, and where a single firm takes advantage of its substantial market power
Determinations	Where parties seek formal clearance of a proposed merger. The Commission will allow the merger to proceed if it is satisfied that it will not substantially lessen competition in any market
Advocacy and Development	Including a range of educative and informative tools such as publishing guidelines (on how to recognise and deter bid-rigging for example), and advice and presentations to ensure that businesses and consumers

Our approach	Explanation
	are aware of and understand competition laws and the benefits of competition
Enforcement philosophy	Developing a philosophy to ensure we apply a consistent framework and stakeholders understand our approach.
Intelligence Unit	Establishment of an intelligence unit to help prioritise our compliance and enforcement work and to actively share knowledge and information with other agencies
Prioritisation	Using a systematic governance approach to prioritisation to ensure we allocate resource to the right mix of investigative and other work such as advocacy.
Relationships	Developing our relationships with other agencies, both domestic and international. For example, the Commission has been liaising with the Ministry of Foreign Affairs and Trade (MFAT) to ensure that we are aware of their priorities and able to leverage off expertise between each organisation. We have also recently entered into an intelligence and information sharing arrangement with the Australian Competition and Consumer Commission (ACCC) and the Singapore Competition Commission with a view to assisting our investigations and exchanging knowledge and best practice.

Achievements/operational successes

41. In recent years the Commission has had considerable success in using this enforcement approach to ensure that markets are competitive. Our achievements in this area reflect our use of litigation and investigations, advocacy and development and regular reviews to increase the efficiency and effectiveness of our work.
42. The Commission has had a significant litigation programme. The courts have imposed increasingly sizeable monetary penalties against parties who have breached the Commerce Act. In the last financial year we collected on behalf of the Crown a total of \$35.4 million in penalties (mostly from three significant cases), as well as reparation of \$2.9 million. The penalties were more than three times the \$8.3 million spent on all of the Commission's major litigation in the year. Over the last five year period from 2006/07 to 2010/11, penalties and cost awards have exceeded the total cost of funding the Commission's major litigation programme.
43. Penalties go back to the Crown and compensation goes to those parties harmed by anticompetitive behaviour. While important, the return on investment of our litigation activity should not be taken out of context with our overall Commerce Act responsibilities. Litigation is one of a number of ways the Commission can address non-compliance and our use of litigation is targeted at matters where we have

considered litigation is the appropriate enforcement response rather than the first course of action.

44. In the last financial year we have completed more coordinated behaviour investigations than forecast. Coordinated behaviour includes both cartel and organised or collusive behaviour which limits competition. The increase is due to the completion of a number of complex long-standing investigations and the starting and completion of a number of new investigations within the year. The new cases have generally been smaller and more confined than in previous years. The case profile has also shifted from international matters to an increased domestic focus.
45. In terms of our advocacy and development work we have been involved in a number of targeted approaches with the aim of increasing understanding around competition, raising voluntary compliance and building internal resource and expertise. Examples include:
- 45.1 undertaking outreach work in the non-residential construction sector to educate businesses and individuals about applicable competition law and the benefits of competition
 - 45.2 carrying out a programme of targeted outreach through speaking engagements to, for example, trade associations and procurement specialists
 - 45.3 providing operational advice and assistance to officials, Ministers and groups (eg BusinessNZ, and Christchurch Building and Infrastructure) on the Commerce Act implications of the Christchurch rebuild effort
 - 45.4 contributing significant resource and expertise to the whole-of-government training project. The project involves the development of National Compliance Qualifications and assessment frameworks for the compliance sector.
46. As it is now best practice in overseas competition agencies, we also look to reviews of our work to test the impact and effectiveness of our interventions. In reviewing two earlier Commission decisions¹ we found that competitive markets were achieved. The reviews showed that the Commission's assessments of the barriers to entry and expansion in particular markets, and choosing not to intervene in other markets, were the right choices for businesses and consumers.
47. The Commission has also developed a way for assessing detriment from anticompetitive conduct. We applied this approach to estimate the economic benefit realised from enforcement interventions like denied merger clearances and court

¹ The two cases involve the following:

1) An investigation into the burnt lime market where the conduct of McDonalds Lime Ltd in response to entry by Perry Lime Limited raised issues in relation to s 27 and 36 of the Commerce Act.

2) Commerce Commission, *Decision No.556: Pyne Gould Guinness Limited/Wrightson Limited* (31 August 2005). This cleared merger decision involved Pyne Gould Guinness Limited/Wrightson Limited and the level of competition in the brassica seed market.

challenges addressing anticompetitive behaviour. The average estimated yearly saving (from avoided detriment) for the five years to 30 June 2010 was \$38.8 million. For the same period, the average yearly costs were \$10.5 million. This demonstrates that the actual benefit realised from the Commission's intervention is greater than the cost of carrying out all our interventions in competitive markets.

Work programme 2011/12

48. Our work over the next year builds on these successes and recognises the importance of supporting businesses to improve compliance, providing them with guidance about whether they risk breaching the law before they proceed, and providing opportunities and incentives for parties to cease unlawful conduct. Our work programme also looks at taking a more flexible and proactive approach to the allocation of resources to deliver on our outcomes in our current Statement of Intent, mindful of the demands on funding across government. Key work streams include:
- 48.1 continuing targeted education initiatives in selected industries
 - 48.2 continuing our focus on publishing fact sheets and guidelines
 - 48.3 updating our investigative and evidence management policies and procedures
 - 48.4 continuing to develop our approach to compliance and enforcement, so that we are able to define and use an appropriate range of predictable enforcement responses
 - 48.5 choosing to litigate where this represents the best enforcement approach
 - 48.6 continuing to connect with overseas and domestic agencies to assist our investigations and to exchange knowledge and best practice
 - 48.7 continuing to give appropriate advice to government on enforcement aspects of consumer and competition law.

Key/Emerging issues

Section 36 of the Commerce Act

49. The Commission's enforcement programme relating to single-firm conduct under s 36 of the Commerce Act continues to be constrained by the practical difficulties in applying the legal tests set down by the Courts. Significantly, a decision by the Supreme Court in 2010 has not delivered the alignment with Australian law or the certainty that the Commission and other stakeholders had hoped for. The decision

involves the Commission's case against Telecom for alleged misuse of market power in the Internet dial-up industry (the '0867 case')².

50. The Commission took the 0867 case to the Supreme Court in order to challenge the narrow approach taken by the Privy Council to finding a misuse of market power and to urge adoption of the more flexible approach taken by the Courts in Australia. In the Commission's view, the Supreme Court has now entrenched the Privy Council's approach, which involves a so-called 'counterfactual test' for determining whether a dominant firm has misused its market power. This test has contributed to significant complexity, uncertainty and expense in previous cases as it requires the Commission and dominant firms to postulate and argue about what the firm would have done in an artificial world in which it did not enjoy market power. In Australia, the Courts have interpreted a similar provision to s 36 in a more flexible way that acknowledges the relevance and application of different (lower threshold) tests, in addition to the counterfactual test, for determining whether a firm has misused its market power.
51. The situation following the 0867 judgment is that the Commission continues to face very practical hurdles to enforcing s 36. There has been widespread criticism of the Supreme Court's reasoning by academics and practitioners, particularly in regard to the Court's characterisation of the prevailing Australian approach which does not accord with most expert views.
52. Commentators have acknowledged the uncertainty that has arisen in the wake of the Court's judgment and identify legislative reform as the most efficient way to adopt the flexibility and lower thresholds applicable in Australia, and to avoid potential enforcement inactivity in an area where cases are inevitably resource-intensive and very costly to bring.³ [*Withheld under section 9(2)(g)(i) of the Official Information Act 1982*]
53. Clarity around the application of s 36 will help the Commission address anticompetitive conduct by single firms more efficiently and effectively. This type of conduct is more prevalent in small economies such as New Zealand's because single firms tend to have a large market share. Addressing anticompetitive behaviour is important to ensure that our economy is productive. Effective competition drives innovation, economic activity and welfare, and positions New Zealand firms to compete offshore.

² *Commerce Commission v Telecom Corporation of New Zealand Limited and Telecom New Zealand Limited* [2010] NZSC 111.

³ For example see Paul Scott "Taking a Wrong Turn? The Supreme Court and Section 36 of the Commerce Act" (2011) 17 NZBLQ 60 and Oliver Meech "Taking Advantage of Market Power" [2010] NZLJ 389.

Commerce (Cartels and Other Matters) Amendment Bill

54. This Bill was introduced to Parliament in October 2011. Should the Bill be passed into law in its present form, it will introduce the option of criminal sanctions for hard-core cartel behaviour (eg price-fixing, bid-rigging, market sharing). The Bill also introduces a new “collaborative activity” defence and proposes a clearance regime for “collaborative activities” that should not be caught by the criminal prohibition. All of these changes will have implications for the Commission. [*Withheld under section 9(2)(g)(i) of the Official Information Act 1982*

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55. It is proposed that the clearance regime will come into force after the Royal assent, likely to be in 2012. This will require the Commission to consider applications for clearance of collaborative activities. A collaborative activity is a new concept introduced by the Bill, and it is not yet clear to the Commission how this concept should be interpreted. The Commission’s approach will be developed over time.

56. It is proposed that the criminal offence provision will come into force two years after Royal assent, likely to be in 2014. The introduction of criminal sanctions means that the Commission will need the ability to conduct cartel investigations to the criminal standard. This requirement would involve the up-skilling of staff in criminal investigation techniques, law and procedures.

General market studies

57. A matter for future assessment is whether the Commission should have power to carry out market studies. Currently the Commission does not have the ability to undertake such studies under the Commerce Act. Having such a power would assist us in achieving our aim of making markets work well for New Zealanders.

58. Market studies are typically examinations into why particular markets are not working well. Competition authorities around the world increasingly use market studies to identify the best remedy for a perceived problem: competition authorities in over 40 countries now have such powers. Market studies often lead to proposals about how markets might be improved. Alternatively, where warranted, they can lead to enforcement action.

59. For the Commission market studies would allow a holistic approach, linking our competition and consumer protection responsibilities. Markets that are not working well can harm consumers, businesses and the economy. For example, consumers may be unable to make informed choices about prospective purchases, businesses may be deterred from improving their products or entering the market and productivity can be undermined.

60. Through gathering intelligence from a range of sources the Commission could identify markets that are not working well. Given the power and resources to do so, we could examine those markets to determine the cause and effect of any problems identified, and how best to address them.

Consumers are better informed

Purpose/context

61. The consumer laws enforced by the Commission are an important foundation of a competitive market economy. New Zealanders benefit and competition is enhanced by businesses providing accurate information to consumers.
62. The Commission enforces legislation that promotes fair competition and consumer confidence about the accuracy of the information they receive when making purchasing choices. The FT Act prohibits false and misleading behaviour by any person in trade. It also gives the Commission enforcement responsibility for a number of regulations promoting product safety and specifying when information about certain products must be disclosed. The CCCF Act requires creditors to disclose certain information to consumers entering into consumer credit contracts, and provides rules relating to interest, payments and fees.
63. As with the Commerce Act the Commission uses a wide range of enforcement tools to enforce compliance with the FT Act and CCCF Act. These enforcement activities include:
 - 63.1 investigating breaches of the FT Act, such as traders providing false or misleading information to consumers or supplying products that might be unsafe
 - 63.2 investigating breaches of the CCCF Act, such as creditors not providing proper disclosure to consumers or charging unreasonable fees
 - 63.3 taking court action
 - 63.4 a range of administrative outcomes, such as settlements, warnings and providing compliance advice
 - 63.5 a proactive programme of advocacy and education; including providing information and guidelines to businesses, professional/trade associations and consumers, to ensure that businesses are encouraged and enabled to comply with consumer laws and that both business and consumers are aware of and understand consumer laws.

Achievements/operational successes

Fair Trading Act

64. In recent years the Commission has had considerable success in using these enforcement tools to promote fair competition and consumer confidence. Our achievements in this area show an effective use of both litigation and advocacy and development to address non-compliance.

65. Our litigation work in enforcing the FT Act is varied. The Commission has taken cases against large corporate entities such as ANZ/ING, the Warehouse and Carter Holt Harvey; securing settlements to the value of \$45 million for around 15,000 investors (ANZ/ING); obtaining over \$200,000 in penalties for multiple breaches of the FT Act (the Warehouse) and settlement of longstanding civil proceedings in a case relating to the misgrading of timber (Carter Holt Harvey). In this last case the company will pay \$1.5 million to a Christchurch Earthquake restoration project, \$100,000 to affected customers and \$50,000 towards the Commission's costs, in addition to a fine of \$900,000 imposed in 2006.
66. We have also taken a number of successful cases against Telecom and Vodafone involving fines of between \$400,000 and \$500,000. The Commission also obtained \$2.7 million in refunds for customers in a settlement with Telecom where a software fault in broadband usage meters resulted in inaccurate readings for approximately 197,000 customers. In this case and three other settlements with Telecom, over \$20 million has been paid in compensation to customers for FT Act breaches. In addition, the Commission has worked proactively with the company to improve its compliance, with the result that complaints to the Commission about Telecom have fallen significantly.
67. Other cases have involved obtaining penalties, compensation, fines and reparations ranging between \$30,000 and \$200,000 for breaches of the FT Act including misleading consumers directly or misrepresenting products to consumers.
68. The Commission also has a successful low level inquiry unit, which achieves speedy resolution of straight-forward FT Act matters. The benefit of this unit is that at very low cost and without resorting to court action, we are often able to resolve issues to the benefit of consumers, and at the same time educate traders about their responsibilities.
69. Our advocacy and development work has involved providing useful information and guidance to traders, consumers and industry bodies. Examples of this work include:
 - 69.1 producing the "An Evening with the Fair Trading Act" DVD, which has been distributed to over 2,200 businesses, consumer groups and organisations with an interest in consumer protection
 - 69.2 providing information to individual businesses and business groups in preparation for the Rugby World Cup to ensure businesses comply with the legislation and were in a position to reap the economic benefits of the event
 - 69.3 initiating a programme with several major companies over the past two years in the telecommunications area, where complaints to us are reviewed in order to identify common themes and ways of improving their compliance levels. It has been pleasing to note a significant reduction in the number of telecommunications consumer complaints we have received, compared with 2009/10.

The Credit Contracts and Consumer Finance Act

70. The CCCF Act relates primarily to consumer credit contracts, including home loans, credit cards, personal loans for vehicles and other consumer goods, consumer finance, payday loans and truck shops.
71. As with the FT Act we continue to use a mix of enforcement tools to achieve the best outcomes for both consumers and businesses, mainly the use of targeted litigation, advocacy and education. In particular we have focused on achieving the best outcomes for vulnerable consumers. This has meant that we have entered a greater number of settlements than prosecutions, better enabling refunds to consumers.
72. When we investigate consumer credit matters, we also consider any potential breaches of the FT Act. Many credit investigations therefore involve both statutes. This overlap is not necessarily well-understood; even creditors who are aware of the CCCF Act may not appreciate that there is overlap with the FT Act. For example, creditors may fail to recognise that breaches of the disclosure requirements in the CCCF Act render their contracts unenforceable, and that if they take steps to enforce these credit contracts they may mislead the debtor about their rights.
73. In addition we have been able to take enforcement action relating to activities connected to consumer credit through the FT Act, but falling outside the CCCF Act. These activities include repossession and debt collection activity and investigations into Christmas hamper and layby sales matters. Since 2005 the Commission has secured refunds and statutory damages (under the CCCF Act) of over \$10.2 million for about 32,800 consumers from Court orders and Commission settlements. The Crown funding during this period has been \$7.2m. We have also achieved convictions against nine creditors (including money lenders and loans companies) against whom fines of \$369,000 were imposed.
74. Our most recent litigation successes include:
- 74.1 achieving convictions against eFeMCee Finance Limited, a one-man finance company which charged debtors unreasonable fees. The case involved the use of a payment protection plan, which was operated as a form of bond. The bond was 31.5% of the amount borrowed, and was added to the loan and incurred interest. The man and company pleaded guilty to 40 charges under the CCCF Act and FT Act and were fined \$55,475 while providing refunds of \$39,000 (2011)
- 74.2 achieving convictions against Wenatex for misleading consumers. Wenatex - a company that sold high-priced “sleep systems” at invitational seminars - failed to inform customers about their rights of cancellation, and on occasion told people they couldn’t cancel or they would forfeit their deposits. Wenatex pleaded guilty to 34 charges under the CCCF Act and FT Act and was fined nearly \$70,000 (2011).
75. We have also been successful in achieving the following administrative resolutions:

- 75.1 Obtaining refunds from GE Money of over \$3 million for customers who had been charged interest incorrectly, after they had bought items on 'interest free' terms (2008)
 - 75.2 Obtaining compensation for customers of over \$500,000 from Budget Loans for breaches of the Fair Trading and CCCF Acts (2010)
 - 75.3 Obtaining refunds for bank customers of \$1.46 million for customers who were charged incorrect mortgage 'break fees' by a range of banks and creditors (2009/10).
76. Our advocacy and development work has focussed on outreach and education.
77. We have also worked hard to establish and maintain strong working relationships with a number of organisations. These include the main banks, a range of other creditors, and consumer advocate groups (such as the Mangere Budgeting Service). Relationships with consumer advocate groups provide us with an intelligence source about serious conduct affecting the most vulnerable debtors, as well as being able to provide support to consumers.
78. In response to the Canterbury earthquakes we provided guidance to debtors on credit issues including the importance of disclosure, debt collection and hardship advice. Another part of our advocacy and education work has been participation in the Ministry of Consumer Affairs' Consumer Day outreach programmes to raise awareness of the consumer rights under the CCCF Act.
79. The Commission also provides certainty to the industry and reduces compliance costs where parts of the CCCF Act are unclear. In particular we have:
- 79.1 published guidelines on reasonable credit fees, insurance commissions and creditors requiring debtors to take out credit related insurance
 - 79.2 published factsheets on various aspects of the CCCF Act, such as disclosure and those aspects of the FT Act that specifically relate to the credit industry eg debt collection practices
 - 79.3 issued a compliance guide to credit card issuers about late payments fees setting out what the Commission considered to be a reasonable level of these fees
 - 79.4 commenced civil proceedings that address non-compliance and clarify the law (*Commerce Commission v Bluestone Mortgages (NZ) Limited* and *Commerce Commission v Motor Trade Finances* are presently before the High Court).

Work programme 2011/12

80. The Commission's FT Act and CCCF Act work in the year ahead recognises the balance between detecting and dealing with business conduct that does not comply with consumer laws, and the need to inform businesses and consumers about these laws and how to comply with them.
81. Our Fair Trading work concentrates on effective enforcement of the FT Act, using a range of tools to address industry and trader practice. Often this is litigation but, as in the recent Telecom settlement, all enforcement is aimed at getting the best possible outcomes for New Zealanders. Improving voluntary compliance is also an important aim of our work and is achieved through increased contact with the business sector and the provision of useful tools (via our website) for building a compliance programme.
82. We have three focus areas for our Fair Trading work: sustainability ('greenwashing'), retail telecommunications, and financial products. With the advent of the Financial Markets Authority (FMA) the Commission's work around financial products and service will reduce – some of our recent large investigations in this area would be matters we expect the FMA would now investigate. It is likely that we will focus on general retail issues if this is supported by the intelligence information we are reviewing currently.
83. For our CCCF Act work the focus is on non-compliance by lower tier lenders. As a result of complaints and intelligence received, as well as the results of a specific project aimed at identifying non-compliant lenders operating in South Auckland, we have visited a number of lower tier lenders and provided them with information about the law. Under the project we will continue to carry out inspections of other lenders around the country and monitor compliance of all lenders we have visited. This project is being led by the Commission, but aspects of it are being operated in conjunction with the FMA. We will also continue to support major litigation which is intended to clarify the interpretation of the CCCF Act. When we consider commencing a prosecution, a key factor will be attempting to remove undesirable persons from the industry.

Key/Emerging issues

Potential amendments to CCCF Act

84. There are two main emerging issues in relation to the CCCF Act:
- 84.1 the Minister of Consumer Affairs (MCA) has recommended to Cabinet that consideration be given to amending the CCCF Act, including who should enforce it

- 84.2 the Financial Markets Conduct Bill effectively removes the Commission's responsibility under the FT Act for enforcing misleading conduct relating to financial products and services. The Bill proposes that enforcement responsibility for such conduct will rest with the FMA.
85. If a policy decision is made to transfer responsibility for CCCF Act and FT Act (financial services) enforcement to the FMA, there will be a number of transition issues. These include:
- 85.1 the status of current Commission litigation proceedings in these areas
 - 85.2 the administration of ongoing financial services investigations and their potential litigation consequences, under both the CCCF Act and the FT Act
 - 85.3 the impact that this move will have on Commission staff working in the CCCF Act area.
86. In previous correspondence with MED we have suggested that these issues could be addressed over a two year transition period. This length of time was suggested in order to assist the FMA in its start up phase. The two year period would also give us sufficient time to address operational and resource implications and to formulate appropriate arrangements with the FMA.
87. The Commission will assist the MCA with the review of the CCCF Act.

Potential amendments to FT Act (Consumer Law Review)

88. The Consumer Law Reform Bill currently before Parliament proposes an enhanced FT Act with some new powers. In the Commission's view this law reform is important in order to:
- 88.1 modernise the consumer law regime in New Zealand
 - 88.2 align it more closely with Australia
 - 88.3 align it more closely with the proposed Financial Markets Conduct Act
 - 88.4 lead to more efficient and effective enforcement.
89. The Commission considers that, although the FT Act presently provides solid protection for consumers, it does not go far enough and is lagging behind policy developments in similar areas. We think there is significant scope for it to be improved, modernised and made consistent with other important consumer protection legislation in New Zealand and Australia.
90. For example, the Australian Consumer Law, the CCCF Act and the proposed Financial Markets Conduct Bill, contain a number of provisions that enable efficient and effective enforcement that are not currently included in the FT Act or in the

Consumer Law Reform Bill before Parliament. These provisions include civil penalties and higher criminal penalties, compulsory interview powers and all-inclusive pricing.

91. Improvements to the FT Act will contribute to economic growth and productivity by fostering competition between traders and increasing consumer confidence in making purchasing decisions. The anticipated amendments will give the Commission access to a wider range of enforcement responses to address non-compliance and foster a climate of voluntary compliance for businesses. The Commission has evolved a more flexible approach to enforcement under the FT Act. This includes greater use of educative initiatives and advocacy as opposed to regular recourse to litigation. A change in the legislative environment as proposed will allow the Commission to provide more cost effective and timely interventions and resolution of breaches. These improvements will make it easier for business to comply with the law and increase consumer understanding.

Regulation is better targeted and more effective

92. Effective and well targeted regulation is important to the New Zealand economy. Businesses and consumers benefit when markets work well, including markets where there is limited competition. Markets where there is limited competition within New Zealand include telecommunications, dairy, electricity lines, gas pipelines and airport sectors. In these markets, regulation is used to help ensure that consumers receive goods and services at a price and quality that would have been available if the market was competitive.
93. A key part of better targeted and more effective regulation is the promotion of long term benefits for consumers. Part of promoting competition includes ensuring there are appropriate incentives to invest in infrastructure, to deliver services efficiently at a quality that customers expect, and that suppliers of these services do not earn excessive profits. Both consumers and investors benefit from well performing businesses that are efficient, innovative and earn an appropriate level of profit.
94. We administer regulatory regimes in the sectors mentioned above. This part of the briefing discusses our regulatory work across these sectors under the following headings:
- 94.1 Part 4 of the Commerce Act (including Input Methodologies and the Regulation of Electricity Lines services, Natural Gas services and Airports services)
 - 94.2 Telecommunications Sector Regulation
 - 94.3 Dairy Sector Regulation.

Part 4 of the Commerce Act

Purpose/context

95. The Commission administers and enforces activities under Part 4 of the Commerce Act (Part 4). The purpose of Part 4 is to promote the long-term benefit of consumers through regulation in markets where there is little or no competition. This is achieved by promoting outcomes consistent with those achieved in competitive markets so that the suppliers of regulated goods and services:
- 95.1 have incentives to innovate and invest
 - 95.2 have incentives to improve efficiency and provide services at a quality that reflects consumer demand
 - 95.3 share with customers the benefits of efficiency gains

- 95.4 are limited in their ability to extract excessive profits.
96. We currently have regulatory responsibility for the following:
- 96.1 electricity lines services (29 electricity distribution services and one transmission service provider, Transpower New Zealand Limited)
- 96.2 gas pipeline services (three gas distribution businesses - Powerco Limited, Vector Limited and Wanganui Gas Limited - and two transmission service providers - Vector Limited and Maui development Limited)
- 96.3 specified airport services such as aircraft and freight activities, airfield activities and specified passenger terminal activities (at Auckland International Airport Limited, Christchurch International Airport Limited and Wellington International Airport Limited).
97. The main mechanisms we use to regulate these businesses are administration of the information disclosure regime and setting and enforcing price-quality paths (both of which are based on input methodologies). The purpose of some of these key regulatory tools are summarised in the table below.

Regulatory tool	Explanation
Information disclosure	<p>Aimed at ensuring there is sufficient information publicly available to enable interested people to assess whether the outcomes that are sought under Part 4 are being achieved. The Commerce Act also requires the Commission to publish a summary and analysis of information that is publicly disclosed by regulated electricity lines businesses. This is intended to promote greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time.</p>
Price-quality regulation	<p>The setting of appropriate price-quality paths. Price-quality paths constrain the amount of revenue that businesses can collect while allowing them to earn a normal return on investment, and set thresholds for quality performance. This ensures that suppliers of regulated services:</p> <ul style="list-style-type: none"> • have incentives to invest and innovate • have incentives to improve efficiency and provide services at a quality that reflects customer demand, and • are limited in their ability to extract excessive profits. <p>A default price-quality path (DPP) is a default set of regulatory provisions covering both price and quality that apply to regulated businesses. A customised price-quality path (CPP) allows the Commission to consider the specific circumstances of a particular</p>

Regulatory tool	Explanation
	regulated business to set a path that better suits their needs.
Input methodologies	<p>Underpin information disclosure and price-quality regulation by setting upfront regulatory rules, processes, requirements and evaluation criteria. The purpose of input methodologies is to promote certainty for suppliers and consumers in relation to these rules, requirements, and processes, and, once determined, they apply to both regulated parties and to us.</p> <p>There are input methodologies for:</p> <ul style="list-style-type: none"> • the allocation of costs to regulated services • the valuation of assets that are used to supply regulated services • the treatment of tax costs for regulatory purposes • estimating the cost of capital • pricing methodologies • rules and processes that set out how price-quality path regulation operates • matters related to CPP proposals.

98. The current focus of our work is on providing certainty, setting price-quality paths (where required), monitoring the performance of regulated services (through information disclosure), and ensuring compliance with regulatory requirements.
99. If regulated businesses do not comply, we can take enforcement action. A key part of our role is to decide which cases we will investigate, and tailor our approach to each issue. This involves selecting the most appropriate enforcement action, which can include issuing a warning letter, reaching a settlement, seeking pecuniary penalties, or proceeding with litigation action.
100. To encourage voluntary compliance and ensure that suppliers act in accord with regulatory requirements, we engage constructively with regulated businesses. This key advocacy and development platform of our work includes working with suppliers to develop the regulatory rules and helping them understand existing requirements.

Achievements

101. We have made significant progress to date in implementing Part 4.
102. A major milestone was the release of five input methodology determinations for electricity lines services, gas pipeline services and specified airport services on 23

December 2010. These input methodologies are under appeal, as anticipated in the legislation. Once the appeals are concluded, the input methodologies will deliver an increase in regulatory certainty.

103. We have also made significant progress in the following areas:
- 103.1 we set the individual price-quality path for Transpower (effective from 1 April 2011). This price-quality path ensures that appropriate regulation is in place for a business that anticipates capital expenditure of up to \$3 billion over the next five years
 - 103.2 we set new information disclosure requirements for specified airport services in December 2010. This will promote improved understanding of the performance of suppliers of airport services.
104. While the Commission is pleased with this progress it is important to note that the Part 4 regime is still being put in place and has not yet operated through the full regulatory cycle.

Work programme 2011/12

105. Building on these achievements, our Part 4 work programme will focus on continuing to put in place the new regulatory requirements for Part 4 of the Commerce Act. In this financial year we will be:
- 105.1 setting the default price-quality path for gas pipeline businesses by 29 February 2012
 - 105.2 setting input methodologies for the approval of Transpower capital expenditure projects
 - 105.3 setting starting price adjustment input methodologies for electricity lines and gas pipelines businesses
 - 105.4 assessing Transpower grid upgrade and capital expenditure proposals
 - 105.5 setting information disclosure determinations for electricity lines businesses and gas pipeline businesses.
106. The completion of these projects will be a significant milestone for the Commission. It will also signal a shift in the Part 4 work from development work to promoting:
- 106.1 voluntary compliance by the suppliers of regulated services
 - 106.2 improved understanding of the performance of regulated businesses
 - 106.3 improved understanding of the benefits of regulation.

107. Other projects to support this work include:
- 107.1 development of enforcement guidelines for suppliers of regulated services
 - 107.2 working with Orion to transition back to compliance with Part 4 over the medium term following the Christchurch earthquakes
 - 107.3 development of a framework for summary and analysis of disclosed information
 - 107.4 working with suppliers and other interested parties to increase understanding of how Part 4 works
 - 107.5 analysis and decision making on CPP proposals.

Key/Emerging issues

108. Legal proceedings (merits reviews) under Part 4 have become increasingly complex and expensive. While these reviews involving input methodologies were expected by all parties, the complex nature of the proceedings will result in some delay in implementing Part 4 and achieving increased regulatory certainty for suppliers and consumers. To some extent the complexity and cost of litigation has been driven by legislative ambiguity. To ensure that the policy outcomes sought under Part 4 are achieved more efficiently and to avoid further potential litigation, constrained legislative amendments to clarify the policy intent of parliament could be warranted.
109. Merits review appeals of input methodologies were lodged by 12 interested parties across all sectors (three have since withdrawn their appeals). Asset valuation and the cost of capital are central to these appeals.
110. Two additional judicial reviews of the Commission's processes have also been sought. These judicial review applications have had the effect of slowing the Court processes down – delaying the hearings for the merits reviews.
111. In the first judicial review the Court has found that an additional starting price input methodology is required to be set. Such an input methodology is not expressly referred to in s 52T of the Commerce Act, following the deletion of this input methodology from the Bill leading up to the Part 4 amendment. The other input methodologies (as set out in s 52T) that the Commission determined in December 2010 continue to stand.
112. The electricity distribution price changes were due to be announced in October 2011 to come in effect by 1 April 2012, but will now be announced in November 2012. The new prices will now come into effect by 1 April 2013. The draft reset (giving effect to the input methodologies) proposed increases in prices for some businesses and decreases in prices for others. The deferral of that reset is of concern to a number of those businesses.

113. The Commission has appealed the decision on the starting price input methodology as it does not believe that an input methodology for starting prices was intended when Part 4 of the Commerce Act was enacted. We are also concerned that the High Court's decision could potentially require the Commission to develop other process input methodologies that we do not believe were intended by Parliament. However, the Commission has commenced work on a starting price input methodology for the EDB mid-period reset to minimise delays in that process.
114. The second judicial review involves four appellants challenging the Commission's cross-sector approach to consultation and decision making in relation to the input methodologies. The appellants argue that the Commission should have taken a rigidly separated approach to different sectors and that it did not give regulated businesses proper notice of its approach. We do not believe that the approach suggested by appellants was practical or would have led to the best outcome. We are awaiting the outcome of the second judicial review.
115. We had anticipated that the merits review appeals would begin in the second half of 2011. However, further litigation generated by judicial reviews brought by regulated parties means that the Court cannot now expedite the hearing of the merits reviews as originally planned.
116. We also note a recent judgment in the Supreme Court involving Telecom and its telecommunications service obligations (TSO). The commentary in the decision may well be relevant to the merits of the asset valuation input methodologies under Part 4 of the Commerce Act, despite the fact that the TSO decision relates to matters under the Telecommunications Act. We are considering this issue further.

Telecommunications sector regulation

Purpose/context

117. The Commission is also responsible for Telecommunications Regulation under Vote Communications.
118. In the telecommunications sector, the regulatory regime focuses on promoting competition for the benefit of end consumers. The Commission has regulatory responsibilities under the Telecommunications Act for the supply of telecommunications services in New Zealand.
119. The Commission has a range of functions under the Telecommunications Act. The main functions include: setting access determinations; calculating the cost of providing service related to telecommunications service obligations (TSO); enforcing its determinations and Telecom's Undertakings; and approving industry codes. Another function is to review competitive conditions in telecommunications markets and, in areas where competition is effective, recommend regulation be removed. Underlying the Commission's work is sector monitoring so we are well placed to

understand when to leave competition to market forces or when intervention is necessary to promote competition.

120. The Commission also has an important role in ensuring that changes to the regulatory regime in response to the UFB initiative are in place. The creation of the UFB network and its associated services is an important development in New Zealand's telecommunications sector.

Achievements

121. The Commission has had some notable success in its regulatory and monitoring work in relation to the telecommunications sector. In 2010/11, we placed a greater emphasis on monitoring telecommunications markets to promote competition in those markets for the long-term benefit of end-users. Significant achievements include:

- 121.1 reaching a settlement with Telecom regarding the alleged discrimination against competitors when supplying unbundled bitstream access (UBA) with sub-loop extension service – prohibited under Telecom's Separation Undertakings. This settlement involves Telecom compensating the affected companies a total of \$31.6 million
- 121.2 completion of a standard terms determination on the price and non-price terms for mobile termination services in response to competition problems in mobile markets
- 121.3 provision of advice to the Ministry of Economic Development (MED) and submissions to the parliamentary select committee on how to establish effective regulatory arrangements for UFB
- 121.4 a report to the Minister recommending significant deregulation of some retail services offered through Telecom's fixed network
- 121.5 a \$1.6 million settlement with Telecom over its loyalty offer which was likely to be a breach of Telecom's Separation Undertakings. The settlement meant that expensive and lengthy litigation was avoided and complainants compensated
- 121.6 a 2Degrees report referring to increase in consumer benefit due to regulation activity.

Work programme

122. Our telecommunications work over the next year will focus on regulatory arrangements for the UFB initiative and market monitoring. Implementing changes required in the light of the UFB initiative, ongoing review of the existing regulatory regime and enhancing our market-monitoring processes are important areas of our work in this sector. This work is important because it ensures that a competitive market is maintained for both businesses and consumers, and, that where markets

have become competitive, we continue to remove or reduce regulation. Our work in this area recognises that a viable Telecommunications sector is important for the long term productivity and economic growth of New Zealand as a whole.

123. Specific areas of focus for our telecommunications work include:
- 123.1 monitoring reports (including mobile termination access services (MTAS) monthly reports)
 - 123.2 completion of a demand side study aimed at identifying issues that might affect the uptake of high speed broadband in New Zealand
 - 123.3 continuing to work with MED officials to provide market-specific advice as input to new policy initiatives and reviews
 - 123.4 development of an information disclosure framework for Local Fibre Companies (LFC)
 - 123.5 monitoring of undertakings compliance for new LFCs and Rural Broadband Initiative providers including Chorus. This will include the development of an advisory role, as new firms are subject to non-discrimination obligations and Chorus's obligations are significantly changed
 - 123.6 extension of broadband performance monitoring to include UFB networks
 - 123.7 continued monitoring of Chorus' copper network Undertaking performance, and further determinations relating to that network, eg determining a cost based price for UBA
 - 123.8 completion of TSO cost allocation and cost calculations.
124. The demand side study is of particular importance. With the UFB initiative many of the supply side issues of high speed broadband have been addressed. Our focus with this study is to understand the issues on the demand side, the incentives for consumers to take up fast broadband, the services that may be available and the problems that may arise on the way.
125. The demand side study is being undertaken under s 9A of the Telecommunications Act, which empowers the Commission to conduct studies relating to the telecommunications industry for the long-term benefit of end-users of telecommunications services within New Zealand.
126. As part of the study the Commission is also organising a conference - The Future with High Speed Broadband: Opportunities for New Zealand - which will be held on 20 and 21 February 2012. The first day of the conference will involve international speakers talking about high speed broadband issues abroad and what the future could look like. The second day will apply international lessons to the NZ environment. We are also conducting subject matter and consumer research, to

understand drivers and barriers to the uptake of fast broadband. The results will be released at the conference.

Key/Emerging issues

Telecommunications (TSO, Broadband and Other Matters) Amendment Act

127. The passing of the Telecommunications (TSO, Broadband and Other Matters) Amendment Act (Amendment Act) heralds the introduction of a new era in the telecommunications sector in New Zealand. The Amendment Act provides for the structural separation of Telecom into two new companies; a wholesale network access provider, Chorus, and a retail service provider, Telecom Retail. The Amendment Act also makes a number of changes to the service descriptions for certain regulated services.
128. The legislation and structural changes to Telecom have implications for both the regulatory regime and structure of the industry as a whole. Although the Commission has completed much of the development of the initial frameworks (in particular the information disclosure regime), it will take some time for these frameworks to 'bed in', and for the industry to accustom itself to the structural changes that have occurred due to regulatory change and new technology.
129. The changes will continue, with the TSO review to be started in 2013, and the review of the regulatory framework to begin in 2016. It will be vital that the lessons learned from the past (including from the 2011 regime) are identified and taken into account in these reviews, ensuring that competition is enhanced as a result.

Implications of TSO decision

130. We note that the Supreme Court has recently held that the Commission's TSO methodology for the 2004/05 and 2005/06 years over-valued Telecom's assets for the purposes of the TSO calculation. We are currently working through how we can most efficiently respond to that judgment in a context where legislative change has made this methodology of historical relevance only.

Dairy sector regulation

Purpose/context

131. The Commission plays a key role in promoting competition in dairy markets. We have enforcement and adjudication roles under the DIR Act the purpose of which is to promote the efficient operation of dairy markets in New Zealand.

132. The DIR Act allows us to undertake enforcement action and requires us to issue determinations to resolve disputes between Fonterra and other parties. An associated piece of legislation is the Dairy Industry Restructuring (Raw Milk) Regulations 2001 (Raw Milk Regulations) which set out obligations around the supply of raw milk. The Ministry of Agriculture and Forestry (MAF) is currently reviewing the DIR Act. One aspect of the review involves considering the process by which Fonterra sets its farm gate milk price. There are concerns that under the current methodology for setting the farm gate price Fonterra can artificially increase that price and make it difficult for competing dairy processors to obtain supply of raw milk from farmers. The Commission is contributing to that review as appropriate.

Achievements/Work Programme

133. We continue to monitor contestability in dairy markets through the entry and expansion of other dairy processors besides Fonterra. We intend to increase our education initiatives about our role in this area and how the pro-competition provisions of the DIR Act work. This focus on information provision and education will ensure shareholding Fonterra farmers are aware of their ability to switch between processors, which is an important aspect of the DIR Act. We also expect to increase our advice to officials on our work in this area.
134. Two separate applications to determine the level of compensation payable to The Grate Kiwi Cheese Company Limited and Kaimai Cheese Company Limited (as a result of the June 2009 determination that Fonterra was in breach of its supply obligations under the Dairy Industry Restructuring (Raw Milk) Regulations 2001) were being considered during the last financial year. However, the Court of Appeal issued its decision on the substantive matter finding that Fonterra had not breached the Raw Milk Regulations. As a consequence there was no need for us to determine any compensation.

Key/Emerging issues

135. The one issue in relation to our work promoting competition in dairy markets is the review of the DIR Act by MAF. Whether this review results in changes to the DIR Act and the work of the Commission will only be clear after this review is completed and any legislation passed.

Organisational Information

Accountability and independence

136. We are an Independent Crown Entity (under s 7 and Part 3 of Schedule 1 of the Crown Entities Act 2004) with some quasijudicial functions established under the Commerce Act.
137. We are primarily accountable to the Minister of Commerce for our performance. We are not subject to direction from the government in carrying out our enforcement and regulatory control activities. This independence requires us to be an impartial promoter and enforcer of the law.
138. Section 26 of the Commerce Act provides a formal and transparent mechanism for the Minister of Commerce to communicate the economic policies of the Government to the Commission. The Commission must have regard to such statements, but it must form its own views about the actions or decisions that are appropriate in each case, consistent with relevant legislation.
139. 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.
140. Where relevant, we use our experience to provide advice on policy development and legislative reviews. The Commission provides independent advice to Government about implementation issues that arise from any legislative changes to the Acts it has responsibility for. It also provides advice to the Minister of Communications and Information Technology about the scope of regulation of telecommunications.
141. Our outputs are delivered under an Output Agreement with the Minister of Commerce and the Minister for Communications and Information Technology. We report to these Ministers on our outputs through Triannual Reports.

Our structure

142. The Commission has two operational branches – Competition and Regulation – supported by the Organisation Performance Branch. Each branch is led by a General Manager who reports to the CEO, who is accountable to the Board. A more detailed organisational chart is provided in Attachment 1.

Board	
Chief Executive	
Competition Branch	Regulation Branch
Organisation Performance	

The Board

143. The Board is made up of Commission Members, appointed by the Governor-General on the recommendation of the Minister of Commerce. The Telecommunications Commissioner is appointed on the recommendation of the Minister for Communications and Information Technology. Associate Commissioners are appointed by the Minister of Commerce. Commission Members have both governance and decision-making roles in exercising the Commission's powers and functions. At least one Commission Member must be a barrister or solicitor. The Board, as a governance body, is required to comply with the duties and requirements of the Crown Entities Act, as well as requirements in other legislation we are responsible for, and provide high-quality, effective governance.
144. 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.
145. The Commission currently comprises 11 members: Dr Mark Berry (Chair), Susan Begg (Deputy Chair), Dr Ross Patterson (Telecommunications Commissioner), Patrick Duignan, Donal Curtin and Anita Mazzoleni (Commissioners). Gowan Pickering, Dr Stephen Gale and Dr Jill Walker are Associate Members of the Commission, and Helen Cull QC and The Hon. Sir Ian Barker QC are Cease and Desist Commissioners.
146. Currently there are cross appointments between the Commission and the Australian Competition and Consumer Commission (ACCC). Dr Jill Walker is a member of the ACCC appointed to the Commission and Dr Mark Berry is an Associate Member of the ACCC.
147. A full list of Commissioners and the senior leadership team is included in Attachment 2.

Relevant Legislation

148. The Commission is a body corporate established under s 8 of the Commerce Act and is an Independent Crown Entity under Schedule 4 of the Public Finance Act 1989. The Commission operates under a number of general and specific regulatory regimes set out in the: Commerce Act, FT Act, Telecommunications Act, DIR Act and CCCF Act.

Capability and Resourcing

Value for money

149. The Commission has continued to deliver on its output levels within a difficult fiscal environment. We demonstrate our value by working within funding levels and looking for efficiencies in our operational work.
150. While the fiscal environment has raised many challenges, we have worked to respond by operating more efficiently and effectively. A key aspect of this response has been to carefully manage our costs within current appropriation levels. The baseline review conducted by MED in 2008 recommended that the Commission would need more resources to fully achieve its outputs. However, due to the changing economic conditions the funding recommendations made in the review were not presented to Ministers.
151. Subsequent Cabinet decisions in 2009 and 2011 approved increased baseline funding for our work under Part 4 of the Commerce Act. However, these increases have been directed at new activities and functions undertaken by the Commission such as establishing and operating grid upgrade plans (GUPs) for Transpower, and considerable work in establishing the regulatory regime after the input methodologies set at the end of 2010. A further review of funding for Part 4 is due to occur in the 2014/15 year.
152. The outcome of the 2008 baseline review has meant that there have been no baseline increases for our General Markets work (taking in our responsibilities under the Commerce Act (apart from Part 4), CCCF Act, and FT Act) and our work in relation to the Telecommunications Act and DIR Act. Given this context we have refocused our efforts to deliver better outcomes and have continued to streamline processes where possible.
153. While our General Markets and litigation activity is funded by the Crown, our industry regulation activity is funded by levies on the particular industries. As a result of this funding arrangement, the Commission is constrained in its ability to apply cost savings in one part of the organisation to another part that may be under pressure due to new activities.
154. At an operational level we continue to look for better and more efficient ways to carry out our work in order to ensure that the funding we receive is used in the most cost-effective way. During 2010/11, we carefully managed our costs and increased productivity across the organisation. We spent \$4 million less than was budgeted and returned \$5.3 million in levy-based funding to the Crown⁴. A surplus of \$3.2 million in General Markets resulted from a combination of a downturn in merger activity, streamlined processes and our organisational restructure. The management of low-level FT Act cases is also an area where we have seen significant efficiency improvements over time. Since we introduced the low level inquiry unit in 2008/09,

⁴ In the 2011 October Baseline Update, \$2.9 million was expense transferred to the 2011/12 financial year.

we have reduced the average cost of these investigations by a third and completed more investigations in a timelier manner.

155. We also look to manage our costs more effectively internally. Restructuring over the past two years has allowed the Commission to work in a more streamlined and efficient way. We also rationalised the size of the organisation and now have a steady maximum of 178 staff positions. We have also been able to reduce our accommodation costs. As a matter of principle the Commission seeks to manage its expenditure within funding levels and return Crown revenue where possible. Similarly, we have retained surpluses (in accordance with our Output Agreement) to build up reserves, effectively using the Commission's balance sheet to underwrite our litigation activity.

Organisation restructure

156. In 2009/10, the Commission established a new, smaller senior leadership team, including grouping operational functions into two branches – Competition and Regulation. In addition to improved coordination of similar activities (increasing scope for efficiency gains), the creation of distinct branches also sought to address some stakeholder perceptions of a potential conflict between the Commission's functions. At the same time an Organisation Performance branch was established to support business performance and improve capability.
157. In 2010/11, we embedded our separate legal and economics branches into the two operational branches, Competition and Regulation. This has resulted in a more cohesive approach to our work, better connectivity between the different elements of analysis and a more streamlined approach to the completion of our work.

Performance improvement

158. Given the need to operate within significant funding constraints, greater emphasis will be placed on performance improvement and prioritisation of work streams. We continue to focus on maximising impact, reviewing productivity and delivering efficiency gains – in essence, doing more with less.

Resourcing for 2011/2012

159. The Commission has offices in Wellington, Christchurch and Auckland and currently has 178 staff. The Commission's operating expenditure budget is \$41.996 million (GST exclusive), across output appropriations set out in accordance with the 2011-14 Statement of Intent.
160. The Commission also receives income from Commerce Act fees, interest, cost recovery and some court-awarded costs.
161. 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 appropriation, and ultimately by participants in each sector by levy set and collected

by the administering Department – the MED or MAF. Under the DIR Act, some of the Commission’s activities are funded solely by the Crown. In each area litigation is funded by the Crown. Attachment 3 shows the Commission’s expenditure compared to appropriations over time.

Key relationships

162. The Commission maintains key relationships with both government and international agencies.

Government

163. The Commission works cooperatively with relevant government agencies to ensure that we achieve our goals without duplication or conflict, and that we share information and expertise where required. In particular the Commission has a number of key relationships with the following Ministries.
164. 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.
165. Ministry of Consumer Affairs (MCA): MCA has the responsibility for providing advice to the Government to establish the policy and legislative framework that supports consumer protection. It has the primary role of helping consumers understand their rights.
166. Ministry of Agriculture and Forestry (MAF): MAF is responsible for providing advice to the Government to establish the policy and legislative framework in relation to the regulation of the dairy industry, specifically the operation of Fonterra.

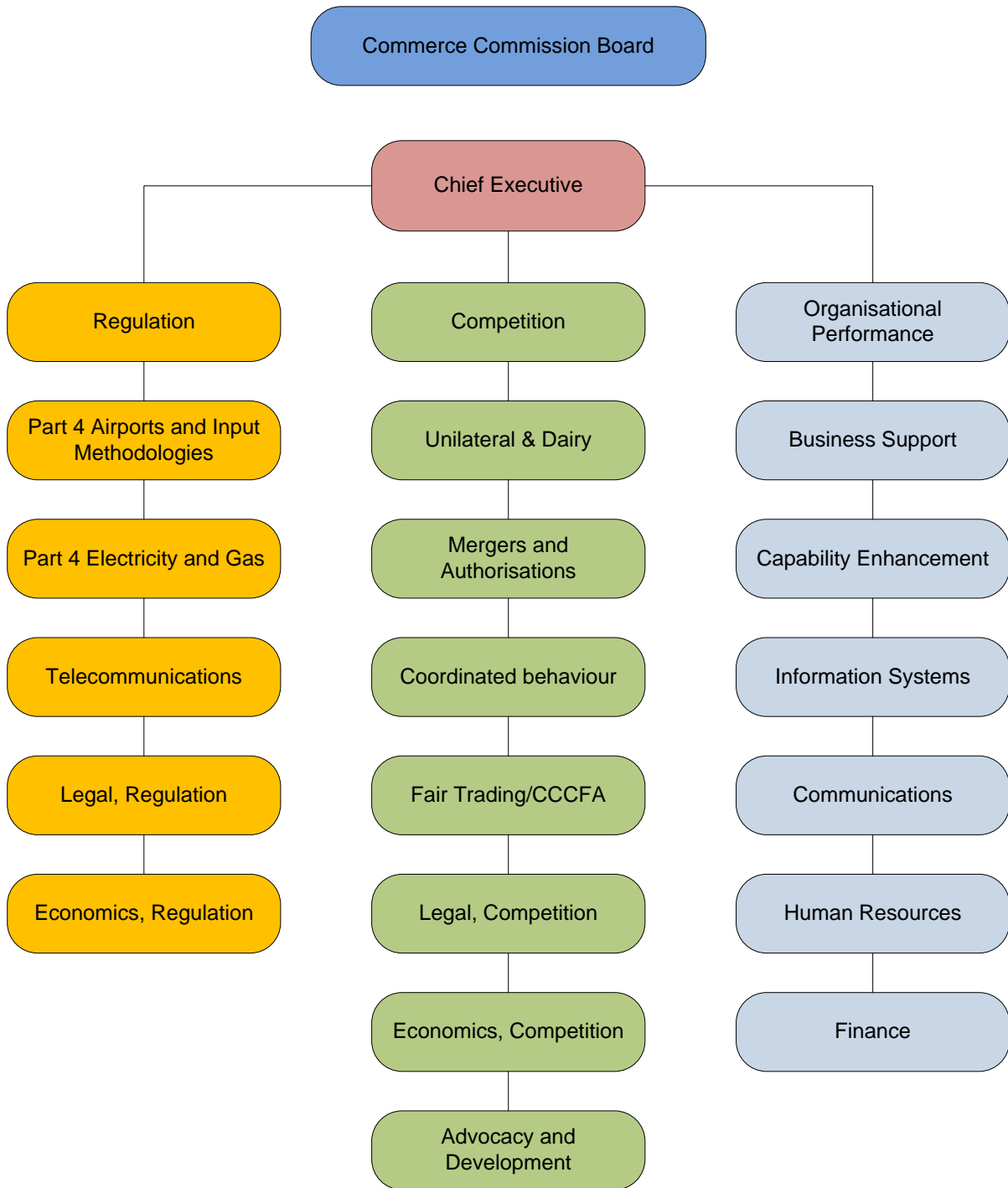
International

167. 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.
168. 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.

169. The Commission also has agreements with several regulatory or competition bodies in other countries. The Commission has co-operation arrangements with the ACCC, the Canadian Competition Bureau and the Taiwan Fair Trade Commission. Our relationship with the ACCC has been strengthened recently with Commissioner cross-appointments. 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).
170. The agencies above share information as allowed by existing privacy and confidentiality laws, co-ordinate enforcement activities where appropriate and avoid any conflict in enforcement action. The Telecommunications Commissioner also participates in regulatory round-table discussions, and staff are involved in International Telecommunications Union activities, as well as contributing to OECD development activities.

Attachment 1

Structure of the Commerce Commission



Attachment 2

Commerce Commission Membership

Dr Mark Berry – Chair

171. Dr Mark Berry was appointed Chair in April 2009; initially for a term of 18 months, this was subsequently extended to five years. He previously held the position of Deputy Chair between 1999 and 2001. Mark has specialised in competition law and economic regulation. He is a former partner in the law firm Bell Gully and former consultant with Chapman Tripp. Since 2002, he has been in practice as a barrister sole. Mark holds a doctorate from Columbia University, New York. He has taught Contract Law, Competition Law and Securities Regulation at Otago University Law School, and is a member of the International Advisory Board at the Institute for Consumer Anti-trust Studies at Loyola University Chicago School of Law. Mark was appointed an Associate Member of the ACCC on 23 November 2010, for a term of three years.

Susan Begg – Deputy Chair

172. Susan Begg was appointed a Commissioner in June 2009 for a term of five years; in July 2010, she was appointed as Deputy Chair for a four-year term. Susan is an economist, and Director of the consultancy company Impetus Group Limited. Her previous roles include Vice-President and head of the economic advisory unit of the investment banking division of Credit Suisse First Boston NZ Limited (and its predecessor companies) and manager of the Macroeconomic Policy section at the Treasury. In her consultancy roles Susan has provided regulatory advice to government and to regulated industries. She was an adviser to the Commerce Commission from 2002 until 2005 on the development of the threshold regime and the Gas Control Inquiry.

Donal Curtin – Commissioner

173. Donal Curtin was appointed as an Associate Commissioner in January 2001, became a full Member of the Commission in November 2002 and was Deputy Chair between July 2008 and March 2009. He resigned as Deputy Chair in March 2009, returning to the role of full Commission Member until his term expires in July 2013. Donal is a business economist with wide experience of applying economics to commercial decisions. He currently runs a consultancy, Economics New Zealand. His previous roles include as Bank of New Zealand's Chief Economist and head of its national private banking unit.

Patrick Duignan – Commissioner

174. Patrick Duignan was appointed an Associate Commissioner in June 2009, becoming a full Member of the Commission in June 2010, until June 2014. He is an economist and corporate financier, who has undertaken a wide range of financial and economic analyses in both the public and private sectors. Patrick's previous roles include General Manager Finance for Telecom Corporation, Director in the Investment

Banking Division of Credit Suisse First Boston NZ Limited, Treasurer of the New Zealand Debt Management Office, and Director Policy Coordination and Development at the Treasury. He is currently an expert (non-board) member of the ACC Investment Committee.

Anita Mazzoleni – Commissioner

175. Anita Mazzoleni was appointed in April 2009 for five years. Anita is an independent corporate finance adviser and company director. She has a BCom and LLB and is a Chartered Accountant and Solicitor (NZ). 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 of Contact Energy, director of Industrial Research Limited, and director of Ngāti Whātua o Orakei companies. Anita is currently a Board Member of the Civil Aviation Authority and Aviation Security Services.

Dr Ross Patterson – Telecommunications Commissioner

176. 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 regulation practice in Australia.

Dr Stephen Gale – Associate Commissioner

177. Dr Stephen Gale was appointed as an Associate Commissioner in July 2010. He has specialised for some years in energy economics and competition proceedings at the infrastructure consulting firm Castalia, and before that at the New Zealand Institute of Economic Research. Stephen has worked on a variety of competition topics including the design of the electricity market, radio spectrum auctions and port pricing. He has advised on mergers in a variety of sectors including forestry, supermarkets, newspapers, dairy products, ready mix concrete, farming hardware, building materials and snack foods.

Gowan Pickering – Associate Commissioner

178. 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 of the Foundation for Research, Science and Technology for four years from 2000. He is currently a director of a number of technology companies and, until June 2010, was a trustee of the Capital Primary Health Organisation.

Dr Jill Walker – Associate Commissioner

179. Dr Jill Walker was appointed as Associate Commissioner in November 2010. She is also a Commissioner of the Australian Competition and Consumer Commission (ACCC) and Chair of the International Air Services Commission in Australia. Before joining the ACCC, Jill was a member of the Australian Competition Tribunal and worked as an economic consultant for LECG Limited, advising both regulatory

agencies and private sector clients on competition and regulatory issues. She holds a BA in Economics and a PhD in Land Economy from the University of Cambridge. She also holds a Master's degree in Economics from the University of Massachusetts.

The Honourable Sir Ian Barker QC – Cease and Desist Commissioner

180. The Honourable Sir Ian Barker QC was appointed in October 2007 for five years. He is a retired Senior Judge of the High Court of New Zealand and a past President of the Arbitrators' and Mediators' Institute of New Zealand.

Helen Cull QC – Cease and Desist Commissioner

181. Helen Cull QC was appointed in October 2007 for five years. She has extensive experience in a range of litigation and in public law and has chaired several national inquiries.

Senior Leadership Team

Brent Alderton – Chief Executive

182. Brent Alderton was appointed as Chief Executive of the Commerce Commission in January 2011. He joined the Commission in early 2009 and later was the General Manager Regulation. Before that, he was Commercial Manager for New Zealand Oil and Gas Limited. Brent's work experience also includes time in Corporate Finance at Deloitte, Corporate Strategy at the Electricity Corporation and in policy and analysis roles at the Treasury and the Department of Social Welfare. Brent has a BA (Hons) in Economics and an MA in Political Studies.

Kate Morrison – General Manager Competition

183. Kate Morrison heads the Competition Branch. She joined the Commission as the first General Manager Enforcement in December 2009. Before her appointment to the Commission, Kate had a London-based career in financial services compliance. Most recently she was Executive Director, Global Head of Compliance for Mergers and Acquisitions, Equity Capital Markets and Global Control Room at ABN AMRO and previously was in a similar role at Deutsche Bank. Kate has a law degree and a BA in English Literature from Wellington's Victoria University and a Masters degree in International Economic Law from Edinburgh.

Dr John Hamill – General Manager Regulation

184. Dr John Hamill has been the General Manager Regulation at the Commerce Commission since January 2011. John had been the Manager for Airports and Input Methodologies in the Commission's Regulation Branch for the previous two years. John is an experienced manager with a strong public sector background. He previously worked at the Ministry of Justice and has demonstrable experience in

strategy, policy development and organisational/sector performance. John has a PhD in English Literature from Victoria University of Wellington.

Geoff Williamson – General Manager Organisation Performance

185. Geoff Williamson joined the Commission in July 2011 and leads the Organisation Performance Branch. Before his appointment to the Commerce Commission, Geoff was Director Corporate Services at the Tertiary Education Commission. His prior work experience includes the role of Chief Financial Officer at the National Library of New Zealand and a range of roles in Deloitte. Geoff has a BCA from Victoria University of Wellington, a Masters in Public Administration through the Australia and New Zealand School of Government, and is a Chartered Accountant.

Attachment 3

Commerce Commission expenditure and appropriation funding

(\$000)	Appropriation 2009/10	Actual expenditure 2009/10	Appropriation 2010/11	Actual expenditure 2010/11	Appropriation 2011/12	SOI forecast expenditure 2011/12	Appropriation 2012/13	Appropriation 2013/14
Non-Departmental Output Expenses								
VOTE: COMMERCE								
Enforcement of Dairy Sector Regulation	905	484	905	437	905	684	905	905
Enforcement of General Market Regulation	16,621	15,896	16,435	14,287	18,073	17,379	16,435	16,435
• <i>Enforcement activity</i>	13,318	12,276	13,935	11,813	13,935	13,241	N/A	N/A
• <i>Internal litigation activity</i>	3,303	3,620	2,500	2,474	4,138	4,138	N/A	N/A
Input Methodologies	4,899	4,910	3,443	3,242	355 ⁴	355 ⁴	0	0
Regulation of Airport Services	500	687	875	695	400	400	1,019	600
Regulation of Electricity Lines Businesses	3,167	2,761	5,117	3,381	4,595 ⁴	4,167 ⁵	4,344	5,539
Regulation of Natural Gas Services	2,700	1,441	2,359	1,548	2,589 ⁴	1,300 ⁴	1,656	1,586
Sub-total	28,792	26,179	29,134	23,590	26,917	24,285	24,359	25,065
VOTE: COMMUNICATIONS								
Enforcement of Telecommunications Sector Regulation	7,790	6,558	7,790	6,079	7,790	6,892	7,790	7,790
Total Non-Departmental Output Expenses	36,582	32,737	36,924	29,669	34,707	31,177	32,149	32,855
Non-Departmental Other Expenses								
VOTE: COMMERCE								
Commerce Commission Litigation Fund	10,500	9,407	8,000	5,856	6,362 ⁴	10,819 ⁴	8,000	8,000
Total	47,082	42,144	44,924	35,525	41,069	41,996	40,149	40,855

⁵ This does not include expense transfers approved in the October Baseline Update for 2011/12.