



COMPETITION COMMITTEE

**ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS
IN NEW ZEALAND**

SEPTEMBER 2003 – AUGUST 2004

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Executive Summary

1. This report summarises the major developments in New Zealand's competition law, the enforcement of that law and in competition policy generally, over the period 1 September 2003 – 31 August 2004.

2. New Zealand's key competition statute is the Commerce Act 1986 which is enforced by the Commerce Commission. Only minor changes were made to the Act during the reporting period. The definitions of goods and services were clarified, and the Commission was allowed more flexibility in conducting its meetings. The Commission has released new Mergers and Acquisitions Guidelines that reflect one year's experience on the part of the Commission and the Courts with the new "substantial lessening of competition" test. A new leniency policy and an amnesty policy for cartels and other anti-competitive behaviour are in the final stages of development.

3. A major study is currently being carried out by the Australian Productivity Commission on long term issues relating to the harmonisation of competition law between Australia and New Zealand. The purpose of the study is to examine options for greater cooperation, coordination and integration of the two countries' general competition and fair trading regimes, and identify whether the expected benefits will outweigh the costs for each country.

4. Some important legislative changes have been proposed, and two discussion documents are expected to be released in the next year. The first will relate to information sharing between the Commerce Commission and overseas competition law enforcement agencies. The second will cover a range of issues under the Commerce Act, including any legislative changes that the government feels are required as a result of the Productivity Commission's study. Some proposed issues for inclusion are the extraterritorial application of the prohibition on anticompetitive business acquisitions, and the threshold for imposing regulatory control under Part IV of the Act. Additionally, an Electricity and Gas Industries Bill has been introduced which will both give effect to the new co-regulatory model for the gas industry, and expand and clarify the functions of the Electricity Commission in its oversight of the electricity industry. A proposed Crown Entities Act purports to strengthen the independence of the Commerce Commission.

5. The Commerce Commission completed 38 investigations into suspected anti-competitive market behaviour over the year to 30 June 2004. The Commission also completed nine merger or acquisition investigations, and decided on 20 clearance applications. The Qantas/Air New Zealand authorisation determination, released in October 2003, is of particular note due to its size and complexity, and is now awaiting decision on appeal in the High Court.

6. During the year, the Commission completed its review under the Telecommunications Act 2001 on the possible unbundling of the local loop. The Commission concluded that unbundling would not be in the interests of competition. However, it has recommended the unbundling of the fixed Public Data Network. Apart from its annual Telecommunications Service Obligations decisions, the Commission has also launched an investigation into whether mobile phone call termination rates should be regulated.

7. The Commission has responsibility for electricity sector regulation under the Electricity Industry Reform Act and Part 4A of the Commerce Act. In the past year, the Commerce Commission has put into place its information disclosure regime, and set a price path threshold and a quality threshold for electricity lines businesses.

8. The Commerce Commission is presently carrying out the Natural Gas Control Inquiry under Part IV of the Commerce Act, and this year released its draft report recommending control in respect of two transmission and three distribution businesses. In the dairy sector, the Commission continues to promote

the efficient operation of raw milk and product markets in New Zealand under the Dairy Industry Restructuring Act 2001.

1. Changes to Competition Laws and Policies, Proposed or Adopted

9. The Commerce Act 1986 is the central pillar of New Zealand's competition legislation. Its purpose is to promote competition in markets for the long-term benefit of consumers in New Zealand. It therefore prohibits various types of conduct that substantially lessen competition in New Zealand markets. There is specific competition legislation for the electricity industry (the Electricity Industry Reform Act 1998 and Part 4A of the Commerce Act), the telecommunications industry (the Telecommunications Act 2001), and the dairy industry (the Dairy Industry Restructuring Act 2001). However, the general competition law set out in the Commerce Act applies to all industries, including those with industry-specific competition legislation, and both the public and private sectors.

10. The Commerce Commission continues to be the primary competition authority in New Zealand. It is an independent statutory body with predominantly adjudicative and public enforcement functions. The Commission is also the industry-specific regulator for electricity (along with the Electricity Commission), telecommunications and dairy markets.

1.1 Summary of new legal provisions for competition law and related legislation

1.1.1 Commerce Act 1986

11. Only minor changes have been made to the Commerce Act in the reporting period. The Commerce Amendment Act was passed in July 2003 to clarify the meaning of goods and services. In particular, it was intended to ensure that the provision of electricity services is subject to the Commerce Act.

12. Another Commerce Amendment Act was passed in April 2004 and allows the Commission's meeting quorum to be determined by the Chairman of the Commission. It allows meetings to be conducted through audio or audio-visual means, and clarifies that Associate Members of the Commerce Commission can carry out functions of Members of the Commission under Acts other than the Commerce Act.

1.1.2 Related Legislation

13. No new related legislation has been passed during the reporting period.

1.2 Other relevant measures, including new guidelines

1.2.1 Mergers and Acquisitions Guidelines

14. In December 2003, the Commerce Commission issued a revised edition of its Mergers and Acquisitions Guidelines. This review was undertaken to provide greater clarity in how the "substantial lessening of competition" threshold was to be applied under s 47, since it changed from the dominance threshold in 2001. The Guidelines were re-drafted after one year's experience with the practical application of the new test. The overall view is that "substantial lessening of competition" means a real or substantial impact on a market in the way of a lessening, hindering or preventing of the process of workable or effective competition.

1.2.2 Leniency and Amnesty Policy

15. The Commerce Commission is at the final approval stages for its revised leniency and amnesty policy. Immunity will be available only to the first person involved in a cartel who reports the cartel to the Commission, and they must not have been the leader of the cartel nor have compelled others to join the cartel. If immunity is obtained, it means the person is completely immune from prosecution by the Commission. Additionally, the person seeking immunity must provide full co-operation to the Commission.

1.3 Government proposals for new legislation

1.3.1 Co-ordination with Australia

16. In August 2003, CER¹ Ministers approved a joint work programme for further co-ordination of competition law, enforcement and institutions. The work programme has three tiers. The immediate issues involve a set of questions that can be worked on now without legislative reform (such as co-ordination on leniency programmes, and the appointment of Australian lay members to New Zealand's High Court to sit on Commerce Act cases). The medium term issues are questions that generally require legislative reform in at least one of the countries to advance (such as sharing of confidential information and cross appointments between Commissions). Work in both areas is progressing well. The Ministers also agreed that the long term issues required more fundamental consideration. Accordingly, the Australian Productivity Commission has undertaken to report on the Australian and New Zealand Competition and Consumer Protection Regimes. The purpose of the study is to examine options for greater cooperation, coordination and integration of the two countries' general competition and fair trading regimes, and assess whether the expected benefits will outweigh the costs.

1.3.2 Commerce Act 1986

17. Two discussion documents are planned for release in the next year by the Ministry of Economic Development. The first discussion paper will be released towards the end of 2004 and will discuss issues relating to information sharing and the provision of investigative assistance between the Commission and overseas competition law enforcement agencies.

18. The second discussion document will cover a range of second-order issues under the Commerce Act, and will cover any legislative changes that the government feels are necessary as a result of the Productivity Commission's study. This document will also address any issues raised as a result of substantial amendments to the Act in 2001, which were designed to enhance key competition thresholds and strengthen deterrents against anticompetitive behaviour. Consideration is being given to including the following issues:

- business acquisitions, in respect of the effective application of the Act to offshore acquisitions, and the overall extraterritorial scope of the Commerce Act;
- the Commission's jurisdiction in restricted trade practices clearances and authorisations, the status of determinations pending appeal, clearance time periods and enforcement of undertakings;

¹ CER is a series of agreements and arrangements that began with the entry into force on 1 January 1983 of the New Zealand Australia Closer Economic Relations Trade Agreement.

- when it is appropriate to impose regulatory control on goods and services, and when the Commission may consider the appropriate form of control; and
- enforcement issues, including in what circumstances it is appropriate to allow the Commission to exercise its power of search and seizure.

19. It is expected that policy will be developed and new laws passed on information sharing in 2005, while the other issues may be dealt with by legislation towards the end of 2005 or 2006.

1.3.3 Public Finance (State Sector Management) Bill

20. The Commerce Commission is a crown entity, which is an organisation in which the state has a controlling interest. The Public Finance (State Sector Management) Bill suggests general changes to the operation of Crown entities. It creates a proposed new Crown Entities Act, an umbrella statute containing consistent governance and accountability requirements for crown entities.

21. Crown entities would fall into categories according to their relationship with the Crown. Under the proposed laws, the Commerce Commission would be known as an Independent Crown Entity (ICE), because of its quasi-judicial nature and because it must operate independently of the government. Thus, the new laws would see a strengthening of the Commission's independence. The Bill has had its first reading and has been subject to scrutiny by the Finance and Expenditure Select Committee. It needs to go through the second and third reading stages before becoming law.

1.3.4 Electricity and Gas Industries Bill

Gas

22. The government has adopted a co-regulatory model for governance of the gas industry, developed due to a consensus view amongst industry participants that the gas industry could not achieve voluntary self-governance. Central to the co-regulatory approach are the proposed new laws to establish a gas industry body, contained in the Gas and Electricity Industries Bill currently before Parliament. The Bill still needs to go through the Second Reading, Committee and Third Reading stages before it can be passed into law.

23. Under the Bill, the Minister of Energy will recommend that an industry body be approved to co-regulate the industry. Under Part 1A of the Bill, the industry body will have the authority to recommend regulations and rules to the Minister in the areas of wholesale, processing, transmission, and distribution. The Minister can only accept or reject recommendations and cannot make their own recommendations in the above areas.

24. In respect of establishing a consumer complaints scheme, customer switching protocols, and developing model consumer contracts, the Minister must allow the industry body a reasonable opportunity to make recommendations. However, the Minister will be able to use his powers to recommend regulations without a recommendation from the industry body in those areas. The Minister can also recommend regulations or make rules in relation to prescribing terms and conditions of access to the Maui pipeline, and other retail or consumer issues, without requiring a recommendation from the industry body. The body will be accountable to the Minister through an annual strategic plan, annual report, and auditor's report. Subpart 2 of the Bill contains backstop powers so that an Energy Commission can be established to fill the shoes of the industry body if co-regulation is not successful.

25. This co-regulatory model has a number of advantages. It is supported by the industry, and the operation and costs of the industry body will be directly borne by the industry participants so governance structures should be more efficient. Further, the industry body will have a comparative advantage over a central regulator in assessing the industry costs and benefits of rules, as it will be able to leverage off the knowledge and experience of industry participants.

Electricity

26. In 2003, an industry referendum was held on the industry self-governance model for electricity. The referendum failed to achieve the majority required across all voting classes for the self-governance model to proceed, leading the government to announce the establishment of an Electricity Commission under the existing Electricity Act 1992, to oversee the governance of the electricity market. The Electricity Commission began operating in September 2003.

27. The Electricity and Gas Industries Bill expands the functions of the Electricity Commission to include ensuring security of supply. The Bill also gives the Electricity Commission regulation-making powers covering matters such as consumer protection, promotion of retail competition, improved information for market participants and development of distributed generation.

28. The industry as a whole continues to be subject to the general provisions of the Commerce Act and to the broad oversight of the Commerce Commission. However, the Bill amends the Commerce Act to clarify the relationship between the Commerce Commission and the Electricity Commission in relation to the control of prices, revenues, and quality standards for electricity distribution businesses. Under the Bill, the Commerce Commission must have regard to Electricity Commission decisions before exercising any of its price control powers.

29. The Bill also provides for the transferring of all of the powers of the Commerce Commission in respect of the price control regime for electricity lines businesses to the Electricity Commission. These powers can be transferred only after 31 March 2009 if certain conditions are met. Prior to any transfer of functions, both Commissions will need to work closely together to ensure that the broad approach to regulating electricity lines businesses is consistent, as there are some potential areas of overlap in their functions under the Bill. For instance, there is some potential for overlap in the information disclosure requirements issued by the two Commissions.

2. Enforcement of Competition Laws and Policies

30. The Commerce Commission is charged with enforcing a range of regulatory regimes, both general and industry-specific. Its key enforcement activities for the year to 30 June 2004 are outlined below.

2.1 Market behaviour activities

2.1.1 Market behaviour investigations

31. The Commerce Commission undertakes market behaviour investigations as part of its responsibilities under the Commerce, Dairy Industry Restructuring (DIR) and Electricity Industry Reform (EIR) Acts. Where a breach can be established as a result of an investigation into alleged anti-competitive behaviour or an alleged breach of the EIR Act, the Commission may opt for either administrative resolution (warnings or settlements) or prosecution.

32. The Commission completed 38 market behaviour investigations into anti-competitive practices, with 36 on hand at the end of the year. Of the investigations completed, court proceedings were issued in

one case for alleged abuse of market power. The Commission issued warnings in six cases and compliance advice letters in five cases. Twenty-six cases were closed with no further enforcement action being taken. The year's most significant investigations are outlined below.

Tranz Rail

33. The Commission investigated Tranz Rail (now Toll NZ Limited) on suspicion that Tranz Rail was acting in an anti-competitive manner, by using its dominant position in the market for the provision of access to its national rail network to reduce competition in the rail passenger excursion and charter market. Tranz Rail denied that it had contravened the Commerce Act. While the Commission considered Tranz Rail's behaviour was at risk of being anti-competitive, Tranz Rail subsequently returned to its original approach to access pricing and other requirements, and this addressed the issues raised by the Commission's investigation. The Commission issued a formal warning to Toll NZ Limited that Tranz Rail's conduct had been at risk of contravening the Commerce Act and that any resumption of such behaviour would be likely to attract Commission enforcement action.

Cardiac anaesthetists

34. A small group of Auckland cardiac anaesthetists' pricing negotiations for a contract between two Auckland hospitals attracted the Commission's attention during negotiations in March and April 2000. The group appointed another anaesthetist to negotiate with one of the hospitals on their behalf. The group had proposed a joint price in respect of one of their fees, and applied for the s 31 exemption for joint ventures. However, the Commission did not consider that the joint venture qualified for the exemption. In addition, the Commission considered that the appointment of the anaesthetist to act on behalf of the group placed them all at risk of breaching the Act. The Commission issued formal warnings to the anaesthetists and their agent.

2.1.2 Civil proceedings taken against anti-competitive market behaviour

Telecom

35. On 18 March 2004, the Commission filed High Court proceedings against Telecom New Zealand Ltd alleging that Telecom misused its market power, and continues to do so, to prevent or deter competition in markets involving high speed data transmission. Around December 1998, Telecom introduced new pricing for its retail high-speed data transmission services. The Commission alleges that in almost all circumstances, the price charged by Telecom for access data tails (required by other telecommunications service providers to supplement their own network) was unreasonably high.

Ophthalmological Society of New Zealand

36. In May 2004, the Commission's prosecution of ophthalmologists culminated in a penalty hearing against the Ophthalmological Society of New Zealand and two individual doctors. This case was significant because it was the first time that a case had been successfully taken against a professional body and professional people under competition law. It was established that there was an anti-competitive arrangement between the ophthalmologists to prevent two Australian doctors from undertaking cataract surgery in Invercargill in 1997. The High Court ordered penalties of \$100,000 against the Society, and a total of \$30,000 against the two doctors. Justice Gendall emphasised that these penalties could not be taken as a guide by other professionals as to the level of future penalties, commenting that they are likely to be many times greater. The Court also ordered that the defendants pay more than \$460,000 costs to the Commission. Five of the six defendants have filed appeals against the Court's findings on liability.

Aquanaut Pty Ltd

37. The Commerce Commission obtained judgment against dive equipment wholesaler Aquanaut for resale price maintenance, in contravention of s 37 of the Commerce Act. Aquanaut admitted that during the period November 1999 - July 2001 it induced, or attempted to induce, the Kaiapoi Dive Shop to refrain from selling any Aquanaut products below the supplier's recommended retail price. Aquanaut agreed to having judgment entered against it, and the Court accepted the suggested penalty of \$60,000.

Carter Holt Harvey

38. In August 2004, the Privy Council released its decision in a case that the Commerce Commission had taken against Carter Holt Harvey for the alleged anticompetitive practices of its subsidiary in 1994. The subsidiary had allegedly engaged in below-cost pricing in order to hinder competition in the South Island insulation market under s 36 of the Act. Under the 1994 law, s 36 was breached if a firm in a dominant position used that dominant position for an anticompetitive purpose. The New Zealand High Court and Court of Appeal both found a breach of s 36, but the majority of the Privy Council overturned that decision, despite a vehement dissent from the minority.

39. The key issue was whether the subsidiary had made use of its dominant position. The Privy Council found that there was no such use under the application of a strict counterfactual test: that is, there can be no abuse of a dominant position (or market power, as the law now stands) unless the action taken is one that could not be undertaken by a firm who was not dominant. In the present case, the majority considered that a non-dominant firm which was otherwise in the same circumstances may well have acted just as the subsidiary had done. In addition, though the subsidiary had been pricing below cost, there was no predatory pricing because there was no intention to recoup losses after the exit of the competitor from the market.

40. This case has important implications for the law under s 36 in New Zealand. First, it reaffirms the importance of the counterfactual test, which New Zealand courts had been reluctant to apply because it narrows the number of successful s 36 actions. Second, the law now clearly requires an intention or ability to recoup losses as a necessary element of a predatory pricing case.

2.1.3 Authorisations of anti-competitive market behaviour

41. The Commission will grant an authorisation under the Commerce Act for an anti-competitive practice if it finds that public benefits directly attributable to the arrangement outweigh any detriment to competition. Two market behaviour authorisations were completed during the year, with none outstanding. The Commission authorised an application relating to the joint marketing of Pohokura gasfield, subject to conditions. It declined a joint application for authorisation from Air New Zealand and Qantas Airways (see Authorisations of mergers and acquisitions below).

Pohokura (Decision 505)

42. Following release of the draft determination in May 2003, the Commission released its final determination into the application for authorisation by OMV New Zealand Limited (OMV), Shell Exploration NZ Limited, Shell (Petroleum Mining) Company Limited, and Todd (Petroleum Mining Company) Limited (Todd) in September 2003.

43. The Commission concluded that on the balance of probabilities, the overall benefit to the public could be substantial and therefore outweigh the detriments. However, for the Commission to be satisfied about this net effect, it required certainty that the arrangement would result in the early production of gas

from the Pohokura field, and that the extent of the detriment to competition caused by joint marketing would be mitigated.

44. Accordingly, the application to jointly market and sell gas from Pohokura was authorised subject to three conditions. Firstly, that the parties could market and sell gas jointly after 30 June 2006 only if the Pohokura field is fully operational by that date. Second, that if the applicants want to sell their interests in the Pohokura field, the sale must be conditional on any purchaser(s) obtaining a clearance or authorisation from the Commission. Finally, the applicants must not prevent purchasers from reselling the gas to third parties.

2.2 *Mergers and acquisitions/market structure activities*

2.2.1 *Investigations into mergers and acquisitions*

45. The Commission completed nine investigations into non-notified mergers or acquisitions during the year, with 12 on hand at the end of the year. These investigations are generally completed in one to two months, but a small number may take longer. The Commission did not issue any new court proceedings during the year.

2.2.2 *Clearances of proposed mergers and acquisitions*

46. Under the Commerce Act, parties may lodge a notice with the Commission seeking a formal clearance of a proposed merger or acquisition. In considering a clearance application, the Commission's role is to determine whether the merger or acquisition has, or is likely to have, the effect of substantially lessening competition in any market. The clearance process has a statutory completion time of ten working days, but this time can be extended by agreement between the applicant and the Commission.

47. The Commission commenced the period with four clearances on hand, and received 24 applications during the financial year. The Commission completed 20 applications and granted seventeen. Of the remaining applications, in one case the Commission was not satisfied that the acquisitions would not result in a substantial lessening of competition in a market. Two clearance applications were withdrawn. The Commission had four applications on hand at the end of the year. Significant clearance decisions are discussed below.

ANZ/National Bank (Decision 507)

48. In September 2003, the Commission cleared the acquisition of National Bank of New Zealand Limited by ANZ Banking Group (New Zealand) Limited. The Commission concluded that the merger was unlikely to substantially lessen competition in inter-bank trading in the foreign exchange, domestic money and bond markets, and in the supply of services like financial planning, managed funds, personal loans, and savings accounts. In other markets, such as the supply of transaction accounts, the merger was considered likely to reduce choice and quality of service. However, any loss of competition in these markets was not considered to be substantial because of competition from three other competitors.

Mitek/Pryda & Reid (Decision 512)

49. In November 2003, the Commission declined to grant clearance to Mitek New Zealand Limited to acquire the assets and liabilities of the Pryda & Reid divisions of Nylex New Zealand Limited. The Commission found that there was likely to be sufficient existing competition or potential competition, to prevent a substantial lessening of competition in markets relating to the supply of non-software supported brackets and braces, and software supported products.

50. However, the acquisition was likely to lead to a substantial lessening of competition in the supply of software-supported connector plates. The Commission considered that potential entry into the market for software-supported connector plates would be insufficient to provide competition to the merged entity. Barriers to entry were high, and while some potential entrants were identified, their entry was considered likely to be insufficient in extent to prevent the merged entity from raising prices or reducing quality. Further, the large fabricators would have limited countervailing power to prevent the merged entity from raising prices or reducing the quality of product and service supplied.

51. The clearance process provides applicants with rights of appeal to the court whereby interested parties can issue administrative law challenges against the Commission. During 2002/03 there were two appeals of the Commission's clearance decisions.

2.2.3 *Authorisations of mergers and acquisitions*

52. Under the Commerce Act, parties may lodge a notice with the Commission seeking formal authorisation of a proposed merger or acquisition. The Commission also considers applications for exemptions under the Electricity Industry Reform Act. Market structure authorisations under the Commerce Act primarily involve proposed mergers and acquisitions where the parties consider that a proposed acquisition will result, or is likely to result, in a substantial lessening of competition in a market. The Commission must grant an authorisation if it is satisfied that the public benefit directly attributable to the acquisition outweighs any detriment.

53. During 2003/04 the Commission did not receive any applications for authorisation for business acquisitions. However, it was still completing an application received in the year prior. This application was submitted in combination with an application for a restrictive trade practice authorisation by Air New Zealand and Qantas Airways. These applications were managed together due to their interconnected nature.

Qantas Airways Ltd and Air New Zealand Limited (Decision 511)

54. In October 2003 the Commission announced its determination to decline authorisation for both the proposed acquisition by Qantas Airways Limited of 22.5 percent of the voting equity in Air New Zealand Limited and a strategic alliance between the two companies.

55. The Commission considered that there would be a substantial lessening of competition in all of the markets in which there would be aggregation between Qantas and Air New Zealand. A large number of markets were defined including main trunk, provincial and Tasman markets, a number of international passenger markets, and some freight markets. In the Commission's view, the annual detriment to the New Zealand public three years after the acquisition was likely to be as much as \$195 million, arising from a combination of allocative, productive and dynamic inefficiency.

56. At the same time, the Commission considered that the benefits to the New Zealand public at that stage which would arise from the proposed alliance would likely amount to \$40.5 million. These benefits included a sizable allowance for potential cost savings of the kind claimed by the airlines, due to their ability to rationalise aircraft capacity, gains to be made by Air New Zealand carrying out Qantas' engineering and maintenance work, and through more convenient scheduling of flights. The airlines also claimed that there would be tourism benefits, but the Commission's analysis indicated that there would be a net decrease of foreign tourists coming to New Zealand.

57. The Commission concluded that the benefits to the public of New Zealand were insufficient to outweigh the competitive detriment likely to arise from the proposed Alliance. The Commission therefore

declined to authorise both applications. The airlines appealed the Commission's decision to the High Court. The appeal has been heard and the judges' decision will be released shortly.

58. Air New Zealand and Qantas also sought a parallel authorisation in Australia, and the Australian Competition and Consumer Commission declined authorisation. The airlines appealed that decision to the Australian Competition Tribunal. The ACT heard the appeal in May 2004 and reserved its decision.

Brambles New Zealand Limited v Commerce Commission

59. This was a significant case because it provided the first case law on assessing mergers and acquisitions using the substantial lessening of competition test, which has been in place since 2001. In March 2003, Brambles lodged an appeal against a Commission decision declining to grant it clearance to acquire a competitor's business in the market for systems of plastic crates, used for transporting fresh fruit and vegetables.

60. In its decision of September 2003, the Court found that the Commission's approach to the substantial lessening of competition test was broadly correct. However, the Court found that the Commission had not properly weighed the evidence and should have given clearance to the proposed acquisition. It was not likely to substantially lessen competition because the prospect of effective and sustainable price collusion or market sharing was unlikely to increase. The High Court's comments in this case about the approach to the new substantial lessening of competition threshold have been taken account of by the Commission in its recently issued Mergers and Acquisitions Guidelines.

3. The Role of Competition Authorities in the Formulation and Implementation of Other Policies

3.1 Telecommunications sector

61. The Telecommunications Act 2001 provides for a dispute resolution regime for designated and specified telecommunications services, administered by the Telecommunications Commissioner and the Commerce Commission. The Commission is required to report on compliance with the Telecommunications Service Obligations and allocate the cost of this to all liable parties. The Commission also has a role under the Telecommunications Act in recommending to the Minister of Communications whether the scope of regulation should be expanded to include new services or altered to amend or remove existing services.

3.1.1 Access Determinations

Interconnection

62. Following the release of the Commission's determination of an interconnection price in November 2002, the Commission received three applications for review of the price set by the determination. The Commission issued a Principles Paper on Total Service Long Run Incremental Cost (TSLRIC) pricing methodology in February 2004, which will be used to assist the Commission in making its final decisions in the interconnection pricing review. The Commission anticipates finalising the review by December 2004.

63. The interconnection price of 1.13 cpm set by the Commission in the initial proceeding has flowed through to the rest of the industry as part of the commercial price set by Telecom following the release of the Determination.

Wholesale (Resale) Services

64. In May 2003, the Commission delivered its final determination (Decision 497) on the resale of Telecom's retail services on a wholesale basis by TelstraClear. These services were primarily for business customers, but included residential broadband services. The Commission set a wholesale price of 16 percent off Telecom's standard retail prices, effective for 18 months from 12 May 2003. Following the release of the determination, both TelstraClear and Telecom New Zealand applied for a review of the discount rate set in the Commission's decision.

65. The Commission anticipates finalising the review of the discount rate by April 2005. The non-price terms and the discount for resale have flowed through to the rest of the industry as part of the commercial terms and conditions set by Telecom following the release of the Determination.

66. On 14 June 2004 the Commission released its final determination on the supply of residential services, including residential local access and calling, network messaging services, fax services, paging services and bundles of residential services. Commercial negotiations between the parties led to a significant narrowing in the scope of the original application. These services had not been available for resale prior to the Commission's determination.

Number Portability

67. In March 2003, five telecommunications carriers applied to the Commission for a determination relating to local telephone number portability and cellular telephone number portability service. The Commission decided to investigate the services in July 2003.

68. The Telecommunications Industry Forum, a self regulatory body, is developing operational and technical standards for number portability in the form of industry codes. The Commission's role in this is confined to determining the formula for how the cost of delivering the service must be apportioned. However, the Commission cannot finalise the determination before the industry codes are completed, as its final determination must provide for the functions and standards of the number portability system. The Commission expects to complete this determination by May 2005.

Local Loop Unbundling

69. Under s 64 of the Telecommunications Act 2001, the Commission was required to undertake a review into whether access to the unbundled elements of Telecom's local loop network and access to the unbundled elements of, and interconnection with, Telecom's fixed Public Data Network should be regulated. The Commission delivered its final report on 22 December 2003, and found insufficient justification to recommend the specification or designation of unbundling of local loops. The experience of a range of other countries with regulated local loop unbundling did not lend weight to the case for New Zealand to follow suit, and the competition impacts were difficult to discern.

70. The Commission recommended that access to an asymmetric Digital Subscriber Line (DSL) bitstream service suitable for the residential and small-to-medium enterprise (SME) broadband market, and the related interconnection, should be a designated service. Additional entry in that market is likely to result in lower prices, acting as a spur to improvements in Telecom's productive efficiency and encouraging process innovation on the part of entrants. Availability of an Asymmetric Digital Subscriber Line (ADSL) bitstream access service is likely to encourage innovation through greater competition.

71. The decision was influenced by Telecom's announcement on 13 November 2003 of its Unbundled Partial Private Circuits service offer. This had the potential to adequately address a major

‘bottleneck’ feature of the market for the provision of high quality committed bit rate services to corporate and other large users. Though the Commission was not satisfied that the offer was suitable in that form, the Commission believed that an opportunity should be allowed for industry negotiations to result in an enhanced service that would promote further competition in that market. The Commission signalled that it would re-evaluate the merits of regulated unbundling of data tails or partial private circuits service at a long-run incremental cost price within six months if this outcome had failed to eventuate.

72. The Minister announced his decision to accept the Commerce Commission's recommendations on unbundling on 19 May 2004. On 28 June 2004 the Commission accepted Telecom's undertaking to offer its Unbundled Partial Private Circuits service at cost-based prices, on the basis of Telecom's commitment to a robust and transparent process for establishing cost based prices, overseen by the Commission.

Mobile Termination

73. The Commission announced on 29 April 2004 that it would undertake an investigation into whether or not mobile phone call termination rates should be regulated. The Commission acted after considering complaints that lack of competition in the mobile termination market meant that charges for fixed-to-mobile calls in New Zealand were unreasonably high. This was the first time that the Commission had looked specifically at the mobile sector under the Telecommunications Act.

74. The Commission has initiated the investigation under Schedule 3 of the Telecommunications Act. Under Schedule 3, the Commission can undertake an investigation into whether or not a new telecommunications service should be regulated. The Commission will then make a recommendation to the Minister of Communications. The Commission expects to complete the investigation by December 2004.

Telecommunications Service Obligations (TSO)

75. *In December 2003, the Commission released its final determination on the calculation of Telecom's net cost of complying with its TSO for the period 20 December 2001 (the commencement date of the Act) to 30 June 2002 (the end of Telecom's financial year). The Commission determined that the cost for that period was \$34.72 million. The cost will be apportioned between telecommunications businesses in proportion to their retail revenues.*

76. The TSO cost is determined on an annual basis. The Commission expects to finalise the TSO determination for 2002/03 by November 2004. Future determinations should be resolved more quickly as parties become familiar with the Commission's requirements.

3.2 Electricity sector

77. The Commission has responsibility for electricity sector regulation under the Electricity Industry Reform Act and Part 4A of the Commerce Act. In addition, the electricity sector is subject to general market regulation under the Commerce and Fair Trading Acts.

3.2.1 Electricity Lines Businesses

78. Part 4A of the Commerce Act gives the Commission responsibilities for the regulation of electricity lines businesses (of which there are currently 29 including Transpower, owner of the national grid). The Commission's responsibilities include:

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

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

Targeted control regime and development of thresholds

80. The purpose of the targeted control regime is to promote the efficient operation of markets directly related to electricity distribution and transmission services through targeted control for the long-term benefit of consumers. This is done by ensuring that suppliers are limited in their ability to extract excessive profits; face strong incentives to improve efficiency and provide services at a quality that reflects consumer demands; and share the benefits of efficiency gains with consumers, including through lower prices.

81. After extensive consultation with interested parties, the Commission on set two thresholds in June 2003: a price path threshold (CPI minus X) and a quality threshold. All lines businesses are required to be assessed under the price path threshold twice, on 6 September 2003 and on 31 March 2004 (30 June 2004 for Transpower). For the first assessment under the price path threshold, a lines business would breach the threshold if its average price as at 6 September 2003 was to exceed its average price on 8 August 2001, when Part 4A of the Commerce Act came into effect. The Commission has substantially completed the first assessments for all lines businesses against that threshold. All lines businesses were assessed against the quality threshold for the first time as at 31 March 2004 (30 June 2004 for Transpower).

82. Following further consultation, the Commission decided to reset the price and quality thresholds for lines businesses for a five year period from 1 April 2004 and for Transpower for one year from 1 July 2004.

83. In February 2004, the Commission commenced an inquiry into the performance of a Hastings-based electricity lines business after it breached the price path threshold as at 6 September 2003. That investigation is continuing. Post-breach enquiries for the same assessment date have also subsequently been commenced into Marlborough Lines Limited and Buller Electricity Limited.

84. Electra Limited, The Lines Company Limited, Centralines Limited and Counties Power Limited issued proceedings in the High Court at Wellington in March 2004 seeking judicial review of the Commission's decision to reset the price path thresholds from 1 April 2004. The plaintiffs claim that the Commission's consultation process was flawed and the Commission's decisions are unreasonable. While the plaintiffs did not seek an interim injunction to stop the publication of the *Gazette* Notice used to reset the thresholds for lines businesses, they are seeking orders to have the thresholds decisions set aside. On 17 May, Unison Network Limited filed a separate statement of claim seeking a judicial review on the grounds that the Commission's decisions are unreasonable.

Information disclosure by electricity lines businesses

85. In June 2003, the Commission issued its information disclosure requirements, which came into force on 1 April 2004. These requirements have, in the first instance, been based on and largely replicate those provided in the Electricity (Information Disclosure) Regulations 1999, administered by the Ministry of Economic Development. The 1999 Regulations have now been revoked. During 2004 the Commission intends to undertake a major review of the information disclosure regime and put in place a revised regime from 1 April 2005.

86. The Commission issued its new ODV (Optimised Deprival Valuation) Handbook on 30 August 2004. This prescribes the methodology for valuing the system fixed assets of electricity lines businesses. The Handbook facilitates consistent comparison of lines businesses asset valuations, as well as financial performance measures based on those valuations.

Electricity Industry Reform Act

87. Under EIR Act, the Commission may grant exemptions if it is satisfied that the cross-ownership or involvement proposed would not inhibit competition in the industry or permit cross-subsidisation of generation assets or electricity retailing with electricity lines businesses. The Commission may also grant exemptions if it is satisfied that the involvement would result in relationships between lines and supply businesses that are at arms length.

88. During the period the Commission received five applications for exemptions under the EIR Act. Four exemptions were granted (two of which were on hand from the previous year), with three on hand at the end of the year.

89. On 31 December 2003 the deadline for complying with the ownership separation provisions of the EIR Act expired. As of this date, electricity lines and supply companies must have ceased all existing cross involvements; otherwise they will be in breach of the Act. It appeared that a number of companies are aware of this expiration and have sought exemptions to prevent them from breaching the Act. The Commission has agreed to grant interim exemptions to these companies to allow time for due consideration of their applications. The Commission also expected a number of further applications for exemption to arrive after the 31 December deadline, and agreed to allow a grace period for companies who are actively attempting to comply with the Act by seeking exemption. The Commission is preparing a proactive programme to identify any companies that are in breach of the Act, but that are not actively seeking exemption.

3.3 Gas sector

3.3.1 Natural Gas Control Inquiry

90. Part IV of the Commerce Act provides that goods and services may be controlled where competition is lessened and the imposition of control would be in the interests of acquirers. In May 2003,

the Commission commenced work on an Inquiry into the supply of gas pipeline (transmission and distribution) services, at the request of the Minister of Energy. The Minister has requested that the Commission report by 1 November 2004. The Minister has asked the Commission in reaching its view on whether control should be introduced for specific advice on:

- Whether goods and services supplied by persons in markets directly related to either a gas transmission system or a gas distribution system or both (gas services) should be controlled under the Commerce Act;
- The methodology that the Commission considers appropriate for the valuation of pipeline assets for the purposes of its advice on the matters covered in the terms of reference;
- The net benefits to the public of control; and
- Any other matter that the Commission considers relevant to a decision on whether control should be introduced.

91. On 21 May, the Commission released its Draft Report. Two transmission businesses and three distribution businesses were recommended for control. Should the Commission recommend gas services be controlled, the Minister has also requested specific advice on the technical provisions relating to declaration of control as set out in s 57A of the Act.

3.4 Dairy sector

92. Under the Dairy Industry Restructuring Act 2001, the Commission's role is to promote the efficient operation of raw milk and product markets in New Zealand. This is effected through enabling new entrant processors to buy raw milk and ingredients from Fonterra Co-operative Group Limited at non-discriminatory prices; monitoring whether Fonterra's farm suppliers are being prevented from entering or exiting in response to price signals; and determining disputes between Fonterra and existing or potential shareholders.

93. The Commission received no new applications for dairy industry behaviour determinations during the year and closed one investigation with no further enforcement action required. However, there are currently two areas of legal activity before the courts in relation to the Commission's work under the Dairy Industry Restructuring Act.

Default Milk Price

94. On 23 December 2003, Fonterra applied to the High Court after the Commerce Commission its wholesale milk price calculation for the 2001-2002 season, under the Dairy Industry Restructuring (Raw Milk) Regulations 2001. Fonterra's application has been made to the High Court for clarification on the interpretation of the legislative provisions.

Discount Rate

95. In March 2004, Fonterra filed for judicial review of the discount rate applied by the Commission in calculating Fonterra's annualised share value for the 2001-2002 season (Decision 501), also under the Dairy Industry Restructuring (Raw Milk) Regulations 2001. Consolidation of the retention proceeding and the discount rate proceeding remains an issue before the court. In May 2004, the High Court ordered the filing and service of evidence relating to both sets of proceedings in accordance with the agreed timetable. A fixture was allocated for September 2004 to determine the issue of consolidation of both proceedings.

4. Resources of Competition Authorities

4.1 Resources overall (current numbers and change over previous year)

Annual budget (in your currency and USD):	2003/04 \$m		2002/03 \$m	
	\$NZ	\$US	\$NZ	\$US
Total Annual Budget	19.2	11.5	17.1	10.1
Enforcement Budget	6.9	4.1	6.3	3.7

(Conversion Rate = 0.60 cents)

96. Please note that the enforcement budget for 2002/03 is different from that disclosed in the previous survey, as an error has been discovered and corrected.

b) Number of employees (person-years):

Category	Numbers	FTE
Economists	5	5
Lawyers	8	8
Other professionals	23	23
Support staff	8.5	8
All staff combined	44.50	44

4.2 Human resources (person-years) applied to

Category	Numbers	FTE
Enforcement against anticompetitive practices ²	30	30
Merger review and enforcement	9	9
Advocacy efforts	5	5

4.3 Period covered by the above information

97. The information collated in the above tables relates to Commission resources as at 30 June 2004.

5. Summaries of References to New Reports on Competition Policy Issues

- The revised leniency policy, to be completed in the coming year, will be available on <http://www.comcom.govt.nz/about/index.cfm>.
- The new Mergers and Acquisitions Guidelines can be found at <http://www.comcom.govt.nz/publications/index.cfm>.

² Excluding unfair or misleading practices which fall under consumer protection provisions of the law, where these exist.

- The Commission's report on Local Loop and fixed Public Data Network unbundling is available at <http://www.comcom.govt.nz/telecommunications/localloop.cfm>.
- Various reports and documents relating to electricity regulation, including the ODV Handbook and Information Disclosure Requirements, are available at http://www.comcom.govt.nz/electricity/Rep_Doc.cfm.
- The Commission's draft report in relation to the Natural Gas Control Inquiry can be found at http://www.comcom.govt.nz/gas/rep_doc.cfm.