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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN NEW ZEALAND

-- 2010 --

This report is submitted by New Zealand to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 19-20 October 2011.

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OECD ANNUAL REPORT ON COMPETITION POLICY IN NEW ZEALAND*1 September 2010 – 31 August 2011***Executive summary**

1. The New Zealand Commerce Commission (NZCC) is the country's competition, enforcement and regulatory agency. The NZCC enforces a number of pieces of legislation that aim to provide the benefits of competition in markets where effective competition does not exist, including the telecommunications, dairy, electricity, gas pipelines and airport sectors.
2. The Government is continuing work on the criminalisation of cartels, and has released a draft exposure Bill. Legislation that will enable information sharing between the NZCC and other competition and consumer authorities is also expected to be passed this year.
3. The Government is undertaking work to strengthen consumers' rights and simplify business through the Consumer Law Reform Bill, which will replace the seven existing consumer laws. Initiatives are also being developed to enhance consumer protection against third-tier lenders under the Credit Contracts and Consumer Finance Act.
4. Several competition developments in the electricity sector have resulted from the passing of the Electricity Industry Act late last year. These include the creation of a new Electricity Authority with a stronger mandate to promote competition and undertake market monitoring.
5. The Telecommunication Amendment Act has also introduced a number of legislative changes to the telecommunications sector including the structural separation of Telecom New Zealand, and other measures to ensure open access of the ultra-fast broadband network.
6. The NZCC continued to enforce a range of general and industry specific industry regimes. The NZCC completed greater numbers of co-ordinated behaviour investigations, merger clearances and investigations into unlawful unilateral behaviour than in the previous year. It has also continued its proactive measures such as publishing fact sheets and guidelines.

1. Background

7. The NZCC is the primary competition authority in New Zealand. It is an independent statutory body with predominantly public enforcement and quasi-adjudicative functions. The NZCC is also the industry-specific regulator for electricity (along with the Electricity Commission), gas, airports, telecommunications and dairy sectors. MED is the primary competition policy adviser to government.
8. The Commerce Act 1986 is the central pillar of New Zealand's competition law. Its purpose is to promote competition in markets for the long-term benefit of consumers within New Zealand. The Commerce Act applies broadly across the economy, including the public sector. The NZCC enforces the Fair Trading Act 1986, which was developed with the Commerce Act to encourage competition and to

protect consumers from misleading and deceptive conduct and unfair trading practices. The NZCC also has statutory responsibility for enforcing the Credit Contracts and Consumer Finance Act 2003.

9. These general market statutes are supplemented by industry-specific competition legislation for the electricity industry (the Electricity Industry Reform Act 1998), the telecommunications industry (the Telecommunications Act 2001), and the dairy industry (the Dairy Industry Restructuring Act 2001).

2. Changes to competition laws and policies, proposed or adopted

2.1 General Markets

2.1.1 Criminalisation of Cartels

10. In January 2010 a discussion document was released for consultation and sought views on whether New Zealand should criminalise hard-core cartel conduct.¹ It noted that increased deterrence could be achieved by:

- Undertaking additional enforcement activity.
- Increasing the level of financial penalties or other forms of penalty.
- Introducing a criminal offence for hard-core cartel conduct.

11. Submissions raised concerns that it would be difficult to express in legislation what constitutes hard-core cartel conduct. If ill-defined, criminal sanctions may:

- Deter pro-competitive behaviour because people would be more risk averse if there was uncertainty around the scope of the prohibition or exemptions; and
- Increase the costs of doing business because people would be more likely to seek specialist advice where there was a risk that the activity they are considering engaging in may be in breach. Furthermore, they could be personally liable, and if liable, may be subject to criminal sanctions.

12. In response to concerns, the government agreed to develop an exposure draft Bill² on cartel criminalisation to test whether it was possible to define the prohibition and exemptions with sufficient clarity, such that any downsides of criminalisation would be remedied or at least mitigated. The exposure draft Bill was released in June 2011, submissions were received and policy decisions are pending.

2.1.2 Commerce Commission (International Cooperation, and Fees) Bill

13. This Bill authorises the NZCC to provide investigative assistance to share information it holds with competition and consumer protection authorities in other jurisdictions, subject to appropriate safeguards. The Bill is currently awaiting its second reading, and it is anticipated that it should be passed next year. Key features of the Bill are:

- A requirement for either a government-to-government or regulator-to-regulator cooperation arrangement to be in place before assistance or information can be provided. The Bill sets out

¹ Ministry of Economic Development, *Cartel Criminalisation: Discussion Document*, January 2010.

² The exposure draft Bill and submissions can be accessed at: http://www.med.govt.nz/templates/ContentTopicSummary_42449.aspx

considerations for the relevant Minister before entering into an arrangement and also specifies things to be included in the arrangement.

- Specific matters for the NZCC to take into account on a case by case basis when considering a request for assistance.
- Provisions that protect privileged material that the NZCC may provide to an overseas regulator, by specifying that the NZCC should not be deemed as waiving its privilege by doing so. Similarly, privileged material that may be provided by an overseas regulator to the NZCC will be deemed as if privileged in the hands of the NZCC, under New Zealand law.

2.1.3 *Consumer Law Reform Bill*

14. The Consumer Law Reform Bill was introduced to Parliament in April 2011. It will strengthen consumers' rights and simplify business compliance by replacing seven existing consumer laws with updated Consumer Guarantees, Fair Trading, and Weights and Measures Acts - as well as a new Auctioneers Act that sets a licensing regime for auctioneers.

15. Some of the key changes include: extending the Disputes Tribunal's jurisdiction to cover complaints about misleading and deceptive conduct; subjecting all new goods sold via auctions - and all goods sold by professional traders through online auction sites - to the acceptable quality provisions of the Consumer Guarantees Act; prohibiting unsubstantiated claims and requiring traders and retailers to ensure their claims are valid; and reconsidering how the Consumer Guarantees Act could apply to electricity and carrier services.

16. The Consumer Law Reform will reduce costs and confusion, and make it easier for consumers and businesses to understand their rights and obligations.

17. The policy objective of the Bill is to revise and update consumer law so that it:

- is principles-based;
- enables consumers to transact with confidence;
- protects suppliers and consumers from inappropriate market conduct;
- is easily accessible to those who are affected by it; and
- achieves alignment with the Australian Consumer Law, as appropriate, in accordance with the Government's agenda of a single economic market with Australia.

18. The Bill contributes to the Government's Regulation Review programme. It modernises consumer law. Several of the existing consumer laws have not been reviewed for many years and are not in accord with modern trading practices such as Internet transactions and telephone and credit card sales. The existing Auctioneers Act 1928 is not in accord with modern occupational regulation practice. Some of the existing consumer Acts have a very narrow subject area and do not need to exist as stand-alone legislation.

2.1.4 *Credit Review*

19. The Credit Contracts and Consumer Finance Act (CCCFA) is the main law applying to credit providers. This law has two primary policy objectives:

- Promotion of competition – achieved through requiring disclosure of interest rates and terms and conditions.
- Protection of consumers – achieved through disclosure, unforeseen hardship protections, oppressive contracts protections and requiring fees are not unreasonable.

20. This law is not providing adequate consumer protections against unscrupulous third-tier lenders (loan sharks, fringe providers) whose lending practices are resulting in severe financial hardship and spiralling debt.

21. Initiatives are currently being developed, in light of consensus amongst stakeholders (community, industry, and government) aired at a Financial Summit held in August 2011.

2.1.5 *Electricity*

22. A number of competition developments in the electricity sector have resulted from the passing of the Electricity Industry Act (EIA) in October 2010. The EIA disestablished the Electricity Commission with existing and new functions transferred to a newly established Electricity Authority and the NZCC. The Electricity Authority was created as an independent regulator, and given a stronger mandate (than the Electricity Commission had) to promote competition and undertake market monitoring. The Electricity Authority is progressing a number of “rules” to promote competition (e.g. financial transmission rights, and more standardised distribution tariffs and contracts) and has invested heavily in promoting customer awareness of the benefits of shopping around for cheaper supply deals.

23. Regulatory oversight of all transmission grid expenditure was transferred to the NZCC, instead of being split between the Electricity Authority and the NZCC. The Act did by adding the approval for Transpower (national grid operator) grid upgrade proposals to the Commerce Act. In addition to this, the determination for a methodology for the review of Transpower’s capital expenditure proposals was added to the Commerce Act.

24. The EIA gave shareholding Ministers power to direct state-owned generator-retailers to undertake a limited reconfiguration of their assets, which included physical asset swaps between Meridian Energy Limited and Genesis Energy Limited, and the sale of Whirinaki power station. The objective was to improve the level of market competition, particularly in the retail sector, and potentially to help improve security of supply.

25. The EIA also required Meridian Energy Limited, Mighty River Power Limited, and Genesis Energy Limited to enter into one-off, long-term (up to 15 years) contracts for financial hedges, which had the aim to facilitate and encourage the SOEs to be more active in retailing nation-wide.

26. The EIA replaced the Electricity Industry Reform Act 1998 (*EIRA*). The enforcement provisions are largely carried over from the existing legislation, although some provisions that are no longer required are not retained. However, the EIA provides for the Electricity Authority to enforce the provisions, not (as currently) the NZCC. This is part of the overall rationalisation of regulatory functions in the EIA, with the Electricity Authority focusing on pro-competitive rules and requirements, and the NZCC focusing on economic regulation (price control) under Part 4 of the Commerce Act 1986.

2.1.6 *Gas & Resources*

27. Two small pipelines were exempted from the requirements of Part 4 of the Commerce Act, following public consultation and recommendation by the NZCC. The gas pipeline services are supplied in a market where the owner of the pipeline does not have a substantial degree of market power.

28. In addition to this, Vector was given an exemption from the requirements to disclose financial statements under the Gas (Information Disclosure) Regulations for its wholesale and retail activities. These Gas Regulations will be replaced next year by a new NZCC disclosure regime that does not require Vector to disclose separate wholesaling and retailing financial statements.

29. The government's interest in New Zealand's mineral estate is managed through legislation: the Crown Minerals Act 1991. A review is currently underway of this Act, which is intended to result in a draft Bill by April 2012 with a new Act by early 2013.

2.1.7 *Telecommunications*

30. The government has launched investment for a new ultra-fast broadband (UFB) initiative to accelerate the roll-out of broadband to 75% of New Zealanders. To support competitive market outcomes, the UFB initiative is designed on an open access model. The requirements for open access are legislated through the Telecommunications (TSO, Broadband, and Other Matters) Amendment Act 2011.

31. The Telecommunications Amendment Act sets out the:

- legislative changes related to the structural separation of Telecom New Zealand (Telecom) - in view of its partnership with the Government in the UFB Initiative;
- obligations in relation to local fibre companies (LFCs) – companies in partnership with the Government in the UFB Initiative;
- measures to facilitate UFB and the Rural Broadband Initiative (RBI) implementation.³

32. The Telecommunications Act 2001 is predicated on Telecom as a vertically integrated company. Under UFB, Telecom will see its existing retail and wholesale businesses separate into two stand-alone companies, Chorus (the network and wholesale company partnering with the Government in the UFB) and Telecom Retail. This represents a change to the way Telecom operates in the market today where its wholesale and retail businesses run in parallel under one company.

33. Telecom-related changes in the Telecommunications Amendment Act fall into two main categories:

- changes to maintain the current safeguards for consumers and competitors in the structurally separated environment; and
- changes that translate rules around Telecom's provision of access services under the current copper access regime, and Telecom's obligations under the Telecommunications Services Obligations framework, into a structurally separated environment.

³ The RBI is intended to deliver on the government's plan to invest NZD300 for vastly improved and affordable broadband services for rural New Zealand over the next five years.

34. Safeguards include changes to the Telecommunications Act that require Telecom to submit an asset allocation plan to the Minister and the NZCC, for the Minister's approval, in consultation with the NZCC. The NZCC's monitoring and enforcement powers will enable the NZCC to assess whether any relevant sharing arrangements comply with the requirements, and to take action if it does not.

35. Structural separation removes many of the incentives for a vertically integrated company to favour its own downstream operations over those of competitors who purchase wholesale inputs from it.

36. To prevent re-integration, changes to the Telecommunications Act prohibit Chorus, or any related party of Chorus, from directly or indirectly, participating in the supply of a telecommunications service to an end user.

37. As the existing operational separation provisions would be unworkable in light of the new industry structure, the Telecommunications Amendment Act repeals provisions that provide for the operational separation of Telecom. This has the effect of removing Telecom's current Operational Separation Undertakings. In a structurally separated environment, the regulatory focus will be on Chorus, which will inherit the key bottleneck assets (specifically, Telecom's copper local loop and regional backhaul networks).

38. In place of the Operational Separation Undertakings, the Telecommunications Amendment Act provides for Chorus to submit open access undertakings for approval by the Minister, specifying the requirements for those undertakings and setting out monitoring and enforcement powers provided to the NZCC to ensure compliance.

39. Telecom currently provides a number of access services under the Telecommunications Amendment Act in relation to the statutory TSO framework that enables the supply of certain telecommunications services which would otherwise not be made available commercially. At a general level, the Telecom TSO Deed will require Telecom to continue to make the retail TSO service as widely available as it was in 2001 at a nationally-capped price. The Chorus TSO Deed will require Chorus to make available to Telecom the network inputs required to deliver the retail TSO service.

40. The Telecommunications Amendment Act also includes a clause for the review of the TSO framework in 2013. The proposed review would consider the impact the UFB and RBI may have on the TSO obligations and the provision of services to the remote rural customer base, as well as the impact of structural separation, and whether other models for addressing commercially non-viable customers are appropriate.

41. An important principle of the proposed amendments is the continuity of the current copper-based services through the structural separation period. This transition would be of critical importance to both the industry and end-users. The most significant amendments in this area are a change in access pricing method (to a cost based approach), and geographic averaging of the pricing of the UCLL service.

42. Changes to the Telecommunications Act require LFCs to provide fibre access services subject to non-discrimination and equivalence obligations. It also prescribes that the NZCC must not commence an investigation into the regulation of that unbundling of layer 1 point-to-multipoint services before the close of 31 December 2019.

43. LFCs are also subject to information disclosure requirements which are enforceable by the NZCC. LFCs are required to provide reliable to the NZCC it to enable over time the costs and characteristics of the LFC fibre networks.

44. The Telecommunications Act has been amended to include provisions which give operators of fibre access networks the right to apply to the District Court for an order granting access for either an initial investigation or a fibre deployment if access was unreasonably withheld.

45. Telecommunications markets may look quite different with the rollout of UFB. For this reason, the Telecommunications Act contains a provision which requires that no later than 30 September 2016, the Minister for Communications and Information Technology commence a review of the policy framework for regulating telecommunications. The review will be required to take into account changes in markets and whether investors have made a reasonable return on their fibre networks, as well as other important competition and consumer interests.

46. As is the case, under the UFB initiative, Telecom is the successful bidder in some regions, and other bidders are successful in other regions. There will be significant scope for efficiencies from involvement by Chorus in the roll out of networks and services by other successful bidders in other regions. The efficiencies would arise from:

- sharing of assets, which would avoid inefficient overbuild;
- sharing of expertise across different regions; and
- greater national consistency across different networks.

47. The Government considers that the efficiency gains of partnership between Chorus and other regional bidders would offset these detriments. In order to ensure that these efficiencies are available, the arrangements for sharing of, or co-investment in, UFB assets between Telecom, the Crown and other UFB partners are authorised through legislation.

48. The legislative framework which provides for the cross-industry funding of TSO instruments has been amended to provide for a fairer allocation of cross-subsidies and to consolidate industry payments into a single telecommunications development levy (the TDL).

2.1.8 Dairy

49. In the previous year, there has been an extension of the pro-competition provisions in the Dairy Industry Restructuring Act 2001. The pro-competition provisions set market share thresholds for a minimum percentage of milk-solids that must be collected by independent processors in a season. The provisions were subject to expiry thresholds and have subsequently been reset.

50. The Ministry of Agriculture and Forestry (MAF) also issued a discussion document⁴ canvassing options for amending the DIRA to ensure the Government's objectives for the New Zealand dairy industry are maintained under Fonterra's proposed move to a Trading Among Farmers system. Submissions on the discussion documents were received and policy decisions are pending.

51. MAF is also undertaking a review of the Dairy Industry Restructuring (Raw Milk) Regulations, and a discussion document⁵ was issued seeking input into a number of issues related to possible improvements to the current working of the Regulations. Submissions on this discussion documents were received and policy decisions are pending.

⁴ The discussion document can be accessed at: <http://www.maf.govt.nz/news-resources/news/trading-among-farmers-prompts-consultation-on-dairy>

⁵ The discussion document can be accessed at: <http://www.maf.govt.nz/news-resources/consultations/review-of-raw-milk-regulations>

3. Enforcement of competition laws and policies

3.1 Action against anticompetitive practices

52. The NZCC continued to prioritise its work on cartels, completing 22 coordinated behaviour investigations. The NZCC received 13 merger clearance applications in the period and cleared 11. The NZCC also completed 13 investigations into unilateral behaviour although a breach of the Commerce Act was not established in any of these cases.

53. The NZCC continued to increase transparency and certainty for external stakeholders by developing and publishing a number of fact sheets and guidelines, including guidelines for procurers on detecting and deterring bid rigging.

54. The NZCC has also launched a programme of directly speaking to industry and trade associations about anti-competitive conduct. An example of this is a programme of getting to understand the competitive processes in the construction sector and advising businesses in the sector on how to avoid breaching the Commerce Act. The NZCC has also had a focus on advising traders of their obligations under both the Fair Trading and Commerce Acts in the lead-up to the Rugby World Cup 2011.

55. At the end of the period (31 August 2011) the NZCC had 10 cartel investigations open (including five international cartels, and 2 trans-Tasman), and three before the Courts.

56. In the relevant period the NZCC received three leniency applications, one of which was declined. Two markers are open as at 31 August 2011.

57. In the relevant period, the NZCC has taken the following action against anti-competitive practices:

- Issued 9 compliance advice letters.
- Settled five matters with out of court/administrative settlements (Waste Oil, Trade Me Tyres, Air Ambulance, and two other confidential matters).
- Made a decision to litigate in relation to one international cartel, but has not yet filed papers.

58. The NZCC has also been involved in the following litigation matters:

- Freight Forwarding – filed in September 2010. We have achieved settlements with five parties in the freight forwarding proceedings, obtaining penalties in excess of \$NZ 8.8 Million (\$US 7.3 Million). The remaining court action against a sixth party is before the NZ High Court.
- Air Cargo –the High Court in August 2011 has found there is a “market in New Zealand” for inbound air cargo services. This clears the way for the substantive price-fixing allegations in relation to inbound and outbound air cargo to be heard next year.
- Also in relation to Air Cargo, in October 2010, the Court of Appeal heard our appeal – and Air New Zealand’s cross-appeal – in the judicial review proceedings brought by Air New Zealand to challenge orders to prohibit disclosure of information, documents or evidence, made under section 100 of the Commerce Act. Our appeal was successful and has not been subsequently appealed by other parties.
- Gas Insulated Switch Gear – the High Court dismissed our claims against Siemens. We have not appealed this decision. A penalty was awarded earlier against Schneider Electric SA.

- Cardboard – our claims against Visy were narrowed by a High Court judgment, limiting the causes of action. All parties are appealing the decision.
- 0867 – in October 2010, the Supreme Court dismissed our appeal in the Telecom 0867 unilateral conduct proceeding. The case was the first opportunity for the Supreme Court to consider and determine the appropriate legal analysis under section 36 of the Commerce Act. This dismissal has brought the proceedings to an end and reaffirmed the counterfactual test in deciding when a firm has unlawfully used or taken advantage of its dominance under section 36.
- Datatails – in April 2011, the High Court imposed a \$12 million penalty against Telecom for breaching section 36 of the Commerce Act in the Datatails case. In 2009, the High Court determined that from 2001 to 2004 Telecom unlawfully leveraged its market power to charge downstream competitors disproportionately high prices for wholesale access to its network, preventing them from offering retail end-to-end high-speed data services on a competitive basis. This decision is under appeal.

3.2 *Mergers and acquisitions*

59. Thirteen merger clearance applications were received in the period. There were no significant cases in the period.

60. All eleven applications that were decided in the period were cleared. Four were classified as straight forward/routine, and seven were classified as moderately complex. They were as follows:

3.2.1 *Straight forward/routine*

- Sanford Limited/Pacifica Seafoods Group
- TEC Projects Limited/Teepak Industries Ltd
- Christchurch International Airport Limited/Craddocks Car Storage
- GEA Process Engineering/ Nu-Con Ltd

3.2.2 *Moderately Complex*

- Scandinavian Tobacco Group A/S / Swedish Match AB
- AsureQuality Limited/Proficiency Services Ltd
- PMP Print Ltd/APN Print Ltd
- Sonoco New Zealand Ltd/ TTL Pacific Ltd
- Fletcher Building Ltd/Crane Group Ltd
- New Zealand Comfort Group Ltd/ Dunlop Living Ltd
- Waters and Farr/ Fletcher Concrete and Infrastructure Ltd

61. Also on the books but not yet decided are:

- Seagate Technology PLC /Samsung Electronics Co Ltd
- Matariki Forests /Selwyn Plantation Board
- Isite Limited/OTW Advertising Limited

4. Resources of Competition Authorities

4.1 Annual budget (in NZD and USD)

- Total Annual Budget for Enforcement Branch (excluding major litigation) 2009/10: \$NZ14.45 million (\$US11.97 million)
- Total Annual Competition Law Enforcement Budget (excluding major litigation) 2009/10: \$NZ 8.444 million (\$US7.000 million)
(conversion rate @ 0.829896 cents)

4.2 Number of employees

62. The NZCC is now separated into two operational branches, Enforcement and Regulation.

63. The Enforcement branch covers two areas of work – competition and informed consumers. Accordingly, the numbers of staff in the table below are those who work in the Enforcement branch, potentially on both competition and informed consumer issues.

Category	Numbers	FTE
Economists ⁶	2	2
Lawyers	15	14.2
Other professionals	52	50.93
Support staff	12	11.5
All staff combined	82	78.63

64. The information collated in the above table relates to NZCC resources as at 31 August 2010.

4.3 Human resources (person-years)

Category	FTE
Enforcement against anticompetitive practices	15.74
Merger review and enforcement	6.79
Advocacy efforts	6.6

65. The information in the above table relates to the period 1 September 2009 – 31 August 2010. It has not been calculated by reference to actual hours worked in the period but rather by reference to FTE hours.

5. Summaries of or references to new reports and studies on competition policy issues

66. In this period the NZCC has not commissioned any reports or studies on competition policy issues.

⁶ There are 5 FTE economist positions but currently only three are filled.