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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN NEW ZEALAND

-- September 1, 2004 through August 31, 2005 --

This report is submitted by the New Zealand Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 19-20 October 2005.

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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 2004 - 31 August 2005.
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, mainly as a consequence of legislative changes in the gas and electricity sectors to clarify the Commerce Commission's functions vis-à-vis the new industry bodies. Consequential changes to the Act were also made to implement the new Crown Entities Act 2004, which strengthens the independence of the Commerce Commission. The Commission's new Leniency and Cooperation Policies were released this year.
3. The Australian Productivity Commission completed its study on long term issues relating to the harmonisation of competition law between Australia and New Zealand. It concluded that there was already a high degree of convergence between the two countries' competition laws and that any differences were not impeding the development of the single economic market between the two countries.
4. A Bill is in development that amends the Commerce Act to authorise the Commerce Commission to provide investigative assistance and share confidential information with overseas competition authorities. A discussion document is expected to be released in the next year and will cover a range of issues under the Commerce Act, including possibly the extraterritorial application of the prohibition on anticompetitive business acquisitions and the regulatory control regime under the Act.
5. The Commerce Commission completed 28 investigations into suspected anti-competitive market behaviour over the year to 30 June 2005. The Commission also completed 14 merger or acquisition investigations, and decided on 18 clearance applications. It resolved 6 merger authorisations under the Electricity Industry Reform Act.
6. During the year, the Commission released its final determination on number portability, requiring industry participants to provide number portability for all local and cellular users by April 2007. The Commission also completed its inquiry into mobile phone call termination rates and recommended that these should be regulated under the Telecommunications Act 2001. The Government has asked the Commission to reconsider a number of matters.
7. The Commerce Commission completed its Gas Control Inquiry under Part 4 of the Commerce Act. The Government accepted its findings that control be imposed on the gas pipeline services of two gas distribution companies. A targeted (thresholds) control regime will also be introduced for all gas pipelines.
8. Reviews into aspects of the government's ownership relationship with the Commerce Commission led to an increase in the Commission's budget.

I. 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.

Summary of new legal provisions for competition law and related legislation

Commerce Act 1986

11. Only minor changes have been made to the Commerce Act in the reporting period. Two Commerce Amendment Acts were passed during the reporting period, mainly to implement changes in the gas and electricity sectors.

12. A Commerce Amendment Act was passed in October 2004 to clarify the relationship between the Electricity and Commerce Commissions in relation to the control of prices, revenues and quality standards for electricity distribution businesses. The amendments also provide for the transferring of all of the powers of the Commerce Commission in respect of the control regime for electricity line businesses to the Electricity Commission. These can be transferred at any time for Transpower (owner of the transmission grid), but only after 31 March 2009 for other lines businesses, if certain conditions are met. The amendments also clarify the relationship between the Commerce Commission and the new gas industry body and Energy Commission, in relation to certain decisions that may be taken under the Gas Act 1992.

13. There was also a technical amendment to the Commerce Act to provide for incorporation of material by reference into regulations setting thresholds for electricity lines businesses.

14. The new Crown Entities Act 2004 made consequential amendments to the Commerce Act to bring it into line with the new governance and accountability provisions applying to all Crown entities. As a consequence, the Commerce Commission's corporate governance arrangements were enhanced, whilst its independent status remained unchanged.

Related Legislation

15. In the reporting period, legislation has been passed in the gas and electricity sectors, with consequential amendments to the Commerce Act (as discussed above). A new Act was also passed during this period to implement the Government's Crown entity reforms.

Amendments to the Gas Act 1992

16. Amendments to the Gas Act 1992 (new Part 4A) were passed in October 2004. These establish a co-regulatory governance body for the gas industry.

17. The gas industry body, now incorporated as the Gas Industry Company, has the authority to recommend regulations and rules to the Minister of Energy in the areas of wholesale, processing, transmission, and distribution. The Minister can only accept or reject recommendations. In respect of establishing a consumer complaints scheme, customer switching protocols, and developing model consumer contracts, the Minister must allow the Gas Industry Company a reasonable opportunity to make recommendations. However, the Minister is 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 Gas Industry Company is accountable to the Minister through an annual strategic plan, annual report, and auditor's report.

18. The amended Gas Act also contains a regulatory backstop so that an Energy Commission can be established to take responsibility for gas industry governance if co-regulation is not successful.

19. The relationship between the Commerce Commission and the new gas governance bodies was also clarified.

Amendments to the Electricity Act 1992

20. The Electricity Act 1992 was amended in October 2004. The functions of the Electricity Commission have been expanded to require the Commission to endeavour to ensure that New Zealand's electricity supply is secure, with adequate reserves for dry years; and to promote and facilitate the efficient use of electricity. The Electricity Commission has also been given regulation-making powers for certain matters (e.g. consumer protection).

21. 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. Consequential amendments to the Commerce Act have clarified the relationship between the Commerce and Electricity Commissions, as described above.

Crown Entities Act 2004

22. The Commerce Commission is a Crown entity, which is an organisation in which the state has a controlling interest. A new Crown Entities Act was passed in October 2004. It provides an umbrella statute containing consistent governance and accountability requirements for Crown entities.

23. Crown entities fall into categories according to their relationship with the Crown. Under the new Act, the Commerce Commission is known as an Independent Crown Entity, because of its quasi-judicial nature and because it must operate independently of the government. The Commission's independence is strengthened in the new Act.

Other relevant measures, including new guidelines

Leniency and Cooperation Policies

24. The Commerce Commission released new Leniency and Cooperation Policies this year.

25. Under its Leniency Policy for Cartel Conduct, the Commission will grant immunity from Commission initiated proceedings to the first person involved in a cartel to come forward with information regarding the existence, activities, operation and membership of the cartel and cooperate fully with the Commission in its investigation and prosecution of the cartel. If the person fails to fully cooperate with the Commission, the Commission may initiate proceedings against that person. Immunity granted from the Commission initiated proceedings cannot exclude claims by third parties who may have suffered loss as a result of the activities of the cartel.

26. Other cartel members who cooperate with the Commission, but who are not the first to formally make a leniency application may make an application under the Commission's Cooperation Policy¹. Where the Commission agrees to proceed under this Cooperation Policy, the Commission will exercise its discretion to take a lower level of enforcement action (e.g. settlement), or no action at all, against an individual or business in exchange for information and full continuing and complete cooperation. An agreement by the Commission to proceed under this cooperation policy does not prevent third party action.

Government proposals for new legislation

Co-ordination with Australia

27. In August 2003, CER² Ministers approved a joint work programme for further co-ordination of competition law, enforcement and institutions. Some aspects of the work programme have already been delivered - for example, co-ordination on leniency programmes, and the appointment of Australian lay members to New Zealand's High Court to sit on Commerce Act cases.

28. Under the agreed work program, the Australian Productivity Commission conducted a study on competition and consumer policy co-ordination between Australia and New Zealand and released its final report in January 2005. The purpose of the study was to examine options for greater cooperation, coordination and integration of the two countries' general competition and fair trading regimes, and to assess whether the expected benefits will outweigh the costs. The Productivity Commission noted that there was already a high degree of convergence between Australian and New Zealand competition laws and that any continued differences were not acting as a significant impediment to the development of a single economic market between the two countries. Both governments have accepted the Commission's recommendations which include:

- Regular policy meetings between Australia and New Zealand competition policy officials;
- Amending competition legislation to provide for enhanced information sharing powers between competition agencies;
- Cross appointments between competition agencies to consider transactions that apply to both jurisdictions.

29. Both countries are making progress towards implementing these recommendations.

Commerce Act 1986

Information Sharing Bill

30. Following the release of a public discussion paper on *Information Sharing by the Commerce Commission* in September 2004, the Government decided in May 2005 to amend the Commerce Act to authorise the Commission to provide investigative assistance to, and share confidential information it holds and compulsorily acquired with, overseas competition authorities, subject to specified safeguards. The main impetus for the review is to facilitate increased enforcement cooperation with the Australian

¹ The Co-operation Policy operates in relation to the Commerce Act, Credit Contracts and Consumer Finance Act 2003, Dairy Industry Restructuring Act 2001, Electricity Industry Reform Act 1998 and Fair Trading Act 1986.

² 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.

Competition and Consumer Commission consistent with promoting a single economic market for Australia and New Zealand.

31. Under legislative proposals currently being developed, the Commission will be able to use its statutory powers (including its power to search) under the Commerce Act to provide investigative assistance to overseas regulators for suspected contraventions of overseas competition laws. The Commission will also be able to share information it holds and obtained by compulsion through the use of its statutory powers under the Commerce Act with an overseas competition regulator, if that information indicates a likely contravention of overseas competition laws.

32. The Commission will be able to provide such investigative assistance and information sharing only pursuant to formal agreement between governments, government departments, or competition regulators (as the case may be). The Commerce Act will specify matters to be considered prior to entering into, and to be included in, any formal cooperation agreements to ensure that the public interest is protected. The Commission will have the discretion, taking into account specified matters, as to its response to requests for assistance.

33. Information obtained other than through the use of the Commission's statutory investigative powers may continue to be exchanged outside of formal agreements, and if confidential or personal, by consent of the parties involved.

34. The Commerce Act will also be amended to allow the Commission to share confidential information obtained through the use of its powers under the Act with other domestic regulators for enforcement purposes (i.e. suspected contravention of other domestic laws).

35. A Bill is currently in development to implement the government policy decisions and is expected to be introduced in late 2005 or 2006. Legislation is likely to be passed in 2006.

Other Commerce Act issues

36. A discussion document is expected to be released in 2006 on a wide range of issues under the Commerce Act. This is likely to include matters relating to coordination issues with Australia and any issues arising 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 Commerce Commission's jurisdiction in restricted trade practices and merger clearances and authorisations, the status of determinations pending appeal, clearance time periods and enforcement of undertakings;
- The regulatory Control Regime (Part 4 and 5 of the Act);
- Joint Trans-Tasman authorisations;
- Enforcement issues, including the Commission's power of search and seizure; and
- Criminal sanctions for cartel behaviour.

Gas

37. Following the outcome of the gas control inquiry (see section III), the government will introduce legislation to implement a targeted (thresholds) control regime for all gas pipelines. Legislation will also be necessary to strengthen the current information disclosure regime for gas pipeline services, and in particular to transfer the responsibility for the information disclosure regime to the Commerce Commission. Legislation should be put in place during 2006.

Telecommunications

38. A limited review of the Telecommunications Act 2001 that focuses on implementation issues is currently being undertaken to improve the workability and effectiveness of the Act. A public discussion paper was released in November 2004 that led to the adoption of policy decisions by the government in August 2005.

39. While the review is mainly focused on implementation issues, the proposed amendments contain some substantial changes to the regulatory regime. One of the most significant amendments would allow the Commerce Commission to resolve access disputes on a multi-lateral basis, similar to reference offer systems in place in other jurisdictions. Other fairly substantial changes include the ability for the Commission to accept formal undertakings from industry players during investigations into whether to regulate additional services, and a reserve power to order interim supply continuity of previously regulated services in specific circumstances. Some of the proposals are more operational in nature and include, for example, improved enforcement procedures such as allowing the Commission to take enforcement action via the courts. A number of fine-tuning amendments have also been proposed in relation to the Telecommunications Services Obligations provisions of the Telecommunications Act. Legislation is expected to be passed in 2006.

II. Enforcement of Competition Laws and Policies

40. 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. More information can be obtained from the Commission's website (www.comcom.govt.nz).

Market behaviour activities

Market behaviour investigations

41. 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.

42. Where, as the result of an investigation into an alleged anti-competitive behaviour or an alleged breach of the DIR or EIR Acts, a breach can be established, the Commission has the option of administrative resolution or prosecution. The Commission employs three broad types of administrative resolution: compliance advice, warnings and settlements. The particulars of each administrative resolution is decided on a case-by-case basis. The emphasis is on rectifying the problems and restoring effective competition.

43. The Commission opened 26 restrictive trade practice investigations under Part II of the Commerce Act during 2004/05 and resolved 28. Such investigations include anti-competitive arrangements between competitors and the use of a substantial degree of market power in a market to hinder competition.

44. Of the 28 investigations resolved, the Commission closed 22 investigations after finding no apparent breach, issued four compliance advice letters and two warnings, and began civil proceedings in one case. Additionally, two criminal proceedings were initiated related to individuals and companies allegedly misleading the Commission. The decision to prosecute has been taken after three years of investigating alleged anti-competitive practices and cartel activity in the timber preservatives industry. The activity is alleged to have taken place both in Australia and New Zealand, with the effect impacting on the market and economy within New Zealand.

Details on the alleged anti-competitive cases are as follows:

Koppers Arch Wood Protection (NZ) Limited and others

45. In April 2005, the Commission filed civil proceedings against four New Zealand companies and seven executives for alleged cartel behaviour in the timber preservatives industry³, alleging that the companies engaged in sharing prices, price fixing, collusion and bid-rigging during a four year period from 1998. The allegations relate to the supply of various wood preservatives, chemicals and assorted services, including copper chromium arsenic (CCA) and light organic solvent preservatives (LOSP). There is a further allegation of attempting to exclude a new entrant and subsequently attempting to eliminate the new entrant from the market.

46. In relation to the same investigation, criminal proceedings were successfully brought against Koppers Arch Wood Protection (NZ) Ltd and its executive Roy Parish, for misleading the Commission and withholding sensitive documents in response to information requisitioning notices under s98(a) and (b) issued by the Commission. Criminal proceedings were also laid against one of the companies and an executive for misleading and deceiving the Commission in an interview that took place in January 2004.

Manawatu Funeral Directors

47. In 2003, six Manawatu funeral directors made a joint tender to the New Zealand Police. The joint tender related to the contract for the transfer of deceased persons on behalf of the New Zealand Police in the Manawatu region.

48. The Commission investigated whether this alleged price fixing would contravene the Commerce Act, by agreeing prices for the supply of services for the 2003 Police Contract. The investigation also involved a consideration of the joint venture exemption available under s31 of the Commerce Act in relation to the joint tender. The nature of the services provided by the funeral directors was not considered likely to fall within this exemption.

49. The six Manawatu funeral directors were warned that, in submitting a joint tender, they were at risk of contravening s27 via s30 of the Act. Letters were also sent to the Funeral Directors Association of New Zealand and the Police, outlining the Commission's concerns in relation to this matter.

Authorisations of anti-competitive market behaviour

50. The Commission will consider applications for and will subsequently 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.

³ Koppers Arch Wood Protection (NZ) Limited, Osmose New Zealand Limited, TPL Limited, Nufarm Limited, Nufarm Australia Limited, Osmose Australia Pty Limited, Koppers Arch Investments Pty Limited and Koppers Australia Pty Limited

51. The Commission commenced the period with no authorisation applications on hand, and initiated action to determine whether an authorisation should be revoked. The Commission did not grant, nor decline to grant, any authorisations, and ended the period with the one application on hand.

Pohokura

52. In September 2003, the Commission granted an authorisation to OMV New Zealand Limited, Shell Exploration New Zealand Limited and Shell(Petroleum Mining) Company Limited and Todd (Petroleum Mining Company) Limited to jointly market and sell gas from the Pohokura field. As the parties have decided to market gas from the Pohokura field separately, this appears to represent a material change in the circumstances around the granting of the original authorisation. This is the first time in fifteen years, and only the second time in its history, that the Commission has considered revocation of an authorisation. Submissions on a draft determination are currently being considered.

Mergers and acquisitions/market structure activities

Investigations into mergers and acquisitions

53. The Commission completed 14 business acquisition investigations into non-notified mergers or acquisitions during the year. These investigations are generally completed in one to two months, but a small number may take longer. The Commission did not instigate any new court proceedings during the year in this regard.

Clearances of proposed mergers and acquisitions

54. 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. This time can be extended by agreement between the applicant and the Commission.

55. The Commission commenced the period with three clearances on hand, and received 22 applications during the financial year, completing 18. Fifteen applications were granted, one of which was conditional on undertakings by the parties that certain assets were to be divested. Of the remaining applications, the Commission declined three. The Commission had four applications on hand at the end of the year.

Vector/NGC Holdings (Decision 540)

56. In August 2004, Vector Ltd submitted an application for clearance to acquire up to and including 100 per cent of the shares of NGC Holdings Ltd. Vector is owned by the Auckland Energy Consumer Trust, and owns and operates a variety of energy-related and telecommunications businesses in Auckland and Wellington. NGC is a public company with interest in gas transmission, distribution and retail, as well as some electricity operations.

57. Significant consideration was given to the impact of the transaction flowing from the resulting vertical integration in the gas supply industry, as well as the significant overlap in electricity metering. As part of a previous consideration (Decision 470) the Commission established that there was limited overlap in the gas distribution market, a relatively small number of consumers and no evidence of switching, and the distribution prices where overlap occurred were similar to the wider Auckland region. This led the Commission to conclude that a substantial lessening of competition was unlikely; the same analysis applied in the context of this application.

58. In terms of the metering market, the Commission considered that while existing competition will provide little or no constraint, potential competition (due to low barriers to entry and ease of expansion of near competitors) and the countervailing power held by large electricity retailers would both provide sufficient constraint post-acquisition.

59. The proposed acquisition would result in increased vertical integration by Vector in gas transmission, distribution and retailing, with Vector holding significant market power in the areas of transmission and distribution. The Commission identified a number of constraints on Vector acting in a manner to influence gas pricing and allocation, and concluded that the increase in vertical integration would not be likely to result in a substantial lessening of competition.

Authorisations of mergers and acquisitions

60. The Commission considers applications for merger and acquisition authorisations under the Commerce Act and exemptions under the EIR Act.

Commerce Act:

61. 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.

Electricity Industry Reform Act:

62. The EIR Act was introduced to reform the electricity industry to better ensure that costs and prices in the electricity industry are subject to sustained downward pressure and the benefits of efficient electricity pricing flow through to all classes of consumers by:

- effectively separating electricity distribution from generation and retail; and
- promoting effective competition in electricity generation and retail.

63. Under the 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.

64. During 2004/05 the Commission received six applications for authorisation of a merger under the EIR Act, with three in hand from the previous year. Three applications were granted and three declined.

Vector/NGC Holdings (Decisions 540 and 541)

65. In concurrent applications, Vector Ltd applied for clearance to acquire up to and including 100 per cent of the shares of NGC Holdings Ltd, and clearance from the EIR Act in respect of a prohibited cross-involvement in an electricity lines and an electricity supply business that would be created as a result of the acquisition. The proposed acquisition would also create a shareholding in Wanganui Gas Ltd, an electricity retailer, and two contracts that hedge against electricity prices (intended to be sold by Vector).

66. The Commission granted the exemption, subject to neither Vector nor NGC nor any of their subsidiaries purchasing a quantity of electricity from the Kapuni Energy Joint Venture that is greater than

necessary to operate the Kapuni Natural Gas Treatment Plant at any time. Unless otherwise permitted by law, Vector will not contract with Wanganui Gas for the conveyance of electricity over Vector's line for the purpose of allowing Wanganui Gas to sell electricity to consumers connected to Vector's lines during the period when Vector continues to have the relevant cross-involvement. Vector must also cease its involvement in the two electricity price hedge contracts owned by NGC.

III. The Role of Competition Authorities in the Formulation and Implementation of other policies

Telecommunications sector

67. 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.

Access Determinations

68. The Commission commenced the year with seven applications for an access determination on hand. The Commission received a further four applications; two were withdrawn by the applicants, with none resolved during the period, leaving nine outstanding at the end of the 2004/05 period.

Interconnection

69. In April, the Commission issued its draft determination on applications by TelstraClear Ltd and Telecom New Zealand Ltd for a review of the interconnection price of 1.13 cents per minute price set by the Commission in November 2002. The Commission expects to release a final determination in September.

70. Telecom had earlier challenged the scope of the Commission's power to carry out this pricing review, and to determine the commencement and expiry dates of the determination. The High Court dismissed Telecom's challenge and ruled that the Commission does have jurisdiction to adjudicate these matters.

Wholesale Determinations

71. In April 2005, the Commission released its draft determination on an application by TelstraClear Ltd for regulated access to Telecom's bitstream service. The Commission's preliminary views is that Telecom should provide TelstraClear with a bitstream access service available nationally with characteristics that differ from Telecom's commercial bitstream service currently available to telecommunications providers.

Wholesale (Resale) Services

72. In April 2005, the Commission released its paper on the principles to be applied in setting the final discount for resale of Telecom's retail services. The Commission had previously set a wholesale price of 16 per cent off Telecom's standard retail prices and both TelstraClear and Telecom had applied for a review of this discount rate.

73. The paper outlined the Commission's views on these cost standards. The Commission will calculate wholesale discounts based on two cost standards: one for price-capped services, and services sold in areas with effective competition, and the other for areas without effective competition. The Commission is currently preparing a request to Telecom to calculate the costs avoided, under s 45 of the Telecommunications Act.

Number Portability

74. The Commission released its final determination on Number Portability on 31 August 2005 in response to two separate applications that were received in March 2003 and December 2004. The determination sets out the standards for implementing industry-wide telephone number portability in New Zealand, and a formula for allocating between carriers the cost of providing the number portability services.

75. The Telecommunications Carriers' Forum (TCF), a self-regulatory body, continued work on developing operational and technical standards for number portability in the form of industry codes. In October 2004, the TCF submitted its draft code for co-location of radio-communications services for approval by the Commerce Commission. In June 2005, the Commission decided that it could not approve the draft co-location as it does not meet the criteria for approval under Schedule 2 of the Telecommunications Act 2001.

Mobile Termination

76. The Commission announced in April 2004 that it would undertake an investigation into whether 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.

77. In June 2005, the Commission recommended to the Minister of Communications that the termination of fixed-line voice calls on a cellular telephone network (excluding third generation (3G) cellular networks) should be regulated. The Commission considered that the limited competition in the market for mobile termination had resulted in mobile network operators setting mobile termination rates for fixed-to-mobile calls significantly above the level required to cover costs, including a reasonable return on capital.

78. Vodafone and Telecom have both applied for judicial review of the Commission's recommendations to the Minister.

79. On 9 August 2005, the Minister of Communications announced that he agrees with the Commission that mobile termination rates were too high, but requested that the Commission reconsider its recommendations on mobile termination rates, and in particular that it:

- give further consideration to the definitional and implementation issues concerning 2G and 3G and to consider possible workable alternatives that would have merit and dynamic efficiency benefits;
- Consider commercial offers made by two telecommunications carriers following the Commission's final report, in comparison to regulation; and
- Give further consideration to how best to ensure that end-users benefit from reductions in wholesale mobile termination rates.

Broadband Monitoring

80. The Commission continued its monitoring of Telecom's performance against its broadband targets of no fewer than 250,000 residential broadband connections by the end of 2005, of which more than a third will be wholesale Jetstream or bitstream products. As at the end of March 2005, Telecom had achieved 68 per cent of the connection target with a total of 169,937 residential broadband connections. Of this number, 17,933 were wholesale connections, representing 21.6 per cent of the wholesale target.

Telecommunications Service Obligations (TSO)

81. In March 2005, the Commission released its final determination on the calculation of Telecom's net cost of complying with its TSO for the period 1 July 2002 TO 30 June 2003. The Commission considered the cost for that period to be \$56.8 million. The cost will be apportioned between telecommunications businesses in proportion to their retail revenues. The TSO cost is determined on an annual basis, with the Commission already commencing work on the TSO cost allocation for 2003/04.

Electricity sector

82. 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.

Electricity Lines Businesses

83. Part 4A of the Commerce Act provides the Commission with regulatory responsibility over large electricity lines businesses, which consist of Transpower and the 28 distribution businesses. The purpose of part 4A 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. The legislation requires the Commission to:

- Develop a targeted control regime for electricity lines businesses by setting performance thresholds;
- Assess lines business against thresholds and determine whether the thresholds have been breached;
- In respect of businesses that have breached their thresholds make control authorisations in respect of price, revenue and/or quality under part 5 of the Act where this would be consistent with the purpose; and
- Develop an information disclosure regime for electricity lines businesses.

Performance Thresholds

84. Price-path (CPI-X) and quality thresholds were set for the electricity distribution businesses for five years from 1 April 2004 and for Transpower for one year from 1 July 2004. These replaced the initial thresholds set in June 2003. The Commission reset Transpower's existing price path and quality thresholds for a 12-month period from 1 July 2005.

85. In March 2005, the High Court in Wellington dismissed claims from four distribution businesses that the Commission's consultation process for setting thresholds was flawed and the threshold decisions were unreasonable. This was the first legal challenge to the Commission's threshold decisions and consultation process. A second judicial review challenge to the reasonableness of the Commission's thresholds is to be heard by the High Court in October 2005.

Post-breach Inquiries

86. The Commission's *Assessment and Inquiry Guidelines* were issued in October 2004, outlining the broad process and analytical framework for assessing threshold compliance, and for undertaking post-breach inquiries under the targeted control regime.

87. Five post-breach inquiries have been opened in respect of breaches arising out of the first and second assessments against the thresholds set in June 2003. A notice of intention to make a declaration of control over Unison Networks Limited was published in September 2005. A decision paper outlining the Commission's reasons and analytical approach was also released. Before it may proceed to a declaration of control, the Commission must consult and have regard to the views of interested parties. An interim application by Unison to prevent the Commission deciding its intention was dismissed by the Court of Appeal.

88. The Commission is now determining whether to publish an intention to make a declaration of control in respect of Marlborough Lines Limited, Buller Electricity Limited and Electra Limited. A post-breach inquiry has also been opened in respect of Transpower.

Information Disclosure Regime

89. The Commission issued its Electricity Information Disclosure Requirements (2004) in March 2004. These largely replicate the requirements previously administered by the Ministry of Economic Development. A comprehensive review of the requirements from first principles is in progress.

*Gas sector**Natural Gas Control Inquiry*

90. In April 2003, the Minister of Energy asked the Commission to make recommendations on whether or not the supply of gas pipeline (transmission and distribution) services should be controlled under Part 5 of the Commerce Act.

91. The Commission's Final Report was released by the Minister of Energy in December 2004. The Commission recommended to the Minister that:

- Control under Part 5 should be imposed on the gas pipeline services of two gas distribution companies (Vector Ltd and Powerco Ltd). The Commission found that gas pipeline prices were only subject to limited competitive pressures and that Vector and Powerco each had substantial

market power and were earning excess returns above their cost of capital to the extent that the Commission was satisfied that control should be recommended; and

- A targeted (thresholds) control regime akin to the electricity targeted control regime should be introduced for all gas (distribution and transmission) pipelines.

92. In July 2005, the Minister of Energy accepted the Commission's recommendations and announced that the gas pipeline services operated in respect of the gas pipelines owned by Powerco and Vector will be subject to control under Part 5 of the Commerce Act 1986. The Order in Council took effect on 25 August 2005 for a period of 11 years.

93. Powerco and Vector have both applied for judicial review of the Commission's final report and recommendations. The Minister of Energy (on behalf of the Crown) has been joined to these proceedings.

Gas Control

94. The Commission is responsible for administering the control regime over Powerco and Vector and has issued a Provisional Authorisation requiring the businesses to reduce their average price at 1 October 2005 by 9.5% (Vector) and 9% (Powerco) from the average price existing at 30 June 2005. Interim applications by Vector and Powerco to direct the Commission's powers were dismissed by the High Court. Work has started on developing a Final Authorisation which may further reduce prices.

95. The Minister also announced that the regulatory constraints for all gas pipelines would be strengthened by the implementation of a targeted (thresholds) control regime modelled on the current electricity lines regime. Legislation will be introduced to Parliament to achieve this and could be in place in 2006.

96. Once the regime is established, the gas pipeline services in respect of the gas distribution pipelines owned by Powerco and Vector will be transferred from Part 5 control to the new targeted (thresholds) regime.

Dairy sector

97. The Commission has both enforcement and regulatory control roles 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 by enabling new entrant processors to buy raw milk and ingredients from Fonterra Co-operative Group Limited (Fonterra) 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 or independent producers.

98. In September 2004, the Commission received an application from the Open Country Cheese Company Limited (Open Country) for a determination under the DIR Act relating to charges for reasonable transport costs with Fonterra. Open Country claimed the two parties have been unable to agree on the value of the transport component of the default milk price for raw milk that Open Country is to purchase from Fonterra.

99. In April 2005, the Commission issued its draft determination, in which it reviewed Fonterra's current method of calculating the reasonable transport cost. Currently, Fonterra applies a national-average based transport charge; the Commission's preliminary finding is that this is not reasonable and that, if the draft view is confirmed, Fonterra would be found to be in breach of the DIR Act. The Commission's preliminary finding is that a methodology based on transport cost-drivers is an appropriate method for determining a reasonable transport cost.

IV Resources of Competition Authorities

1. Resources overall (current numbers and change over previous year):

a) Annual Budget (in your currency and USD):

Annual budget (in your currency and USD):	2004/05 \$m		2003/04 \$m	
	\$NZ	\$US*	\$NZ	\$US**
Total Annual Budget	21.0	14.5	19.2	11.5
Enforcement Budget	6.8	5.2	6.9	4.1

(* Conversion Rate @ 0.68 cents; ** Conversion Rate @ 0.60 cents)

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

2. Human resources (person-years) applied to:

Category	Numbers	FTE
Enforcement against anticompetitive practices	30	30
Merger review and enforcement	9	9
Advocacy efforts ⁴	5	5

⁴ The Commission does not advocate. These figures are litigation efforts for the period.

3. Period covered by the above information:

100. The information collated in the above tables relates to Commission resources as at 30 June 2005.

4. Reviews of the Commerce Commission:

101. In April 2005 the Government completed four related reviews into aspects of the Government's ownership relationship with the Commerce Commission. The reviews focused on how the current structural and resource constraints impacted on the Commission's operation. The reviews generally confirmed that the framework for resource allocation strikes the appropriate balance between flexibility for the Commission and accountability to Government. The reviews also identified that increased complexity and demand and changes in the business and policy environments are placing strain on the Commission's resources. Following the reviews, the Government increased the budget allocated to the Commission which should enable it to focus on areas that have a longer term focus.

V. Summaries of references to new reports on Competition Policy Issues

- Commerce Commission's Leniency Policy and Cooperation Policy ;
- Australian Productivity Commission's Report on Australia and New Zealand Competition and Consumer Protection Regime;
- Consultation Document on Information Sharing by the Commerce Commission;
- The Commission's Final Report and Advice to Minister on the Gas Pipeline Control Inquiry have been released in 2005; and
- Mobile Termination Rates, including Commerce Commission's Final Report ;