



Commerce Commission

Briefing for incoming Minister

October 2014

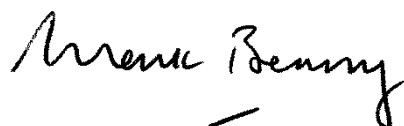
PUBLIC VERSION

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Chairman's foreword

1. As New Zealand's competition and regulatory agency our purpose is to achieve the best possible outcomes in competitive and regulated markets for the long-term benefit of New Zealanders.
2. Competition is a key driver for delivering greater productivity and growth in the New Zealand economy. Effective competition creates an incentive for firms to innovate, improve efficiency and produce products and services at a price and quality demanded by consumers. As an effective competition agency and regulator we help to ensure consumers are protected and regulated businesses face incentives to perform and invest. In doing this we contribute to the Government's broader priorities such as building a more competitive and productive economy.
3. We are committed to getting out into communities around New Zealand to increase understanding of the law, encourage compliance and detect breaches, particularly where vulnerable consumers are involved. We are focused on using our resources wisely using our enforcement guidelines in order to achieve the greatest impact for consumers.
4. The Commission has a large work programme planned for the next financial year and we will of course take on cases as they come to our attention. We are acutely aware of the environment in which we operate, and in which businesses and our regulated suppliers operate. We are aware of the importance of predictability and timeliness in our decisions within those environments. Our stakeholders are a vital part of our work and we are focused on constructively engaging with them. We are committed to making sure that we have high quality staff producing high quality work.
5. Details of our current investigations are not included in this briefing. We plan to update you in person on these investigations, where appropriate, at our first meeting. We look forward to meeting with you and providing further information on our current work programme including upcoming cases and issues.



Dr Mark Berry
Chairman

Purpose

6. The purpose of this briefing is to give you an overview of the Commerce Commission (Commission) highlighting our areas of focus and emerging issues. More detail is provided about the Commission in our 2014-18 Statement of Intent, 2014/15 Statement of Performance Expectations and 2012/13 Annual Report (copies are attached). Our 2013/14 Annual Report will be available at the end of October.
7. The briefing includes an overview of the role and function of the Commission, organisational information about our structure, resourcing and capability. It also includes an overview of the Commission's key achievements over the last three years, key areas of focus in the medium term as well as key challenges we would like to bring to your attention as responsible Minister.

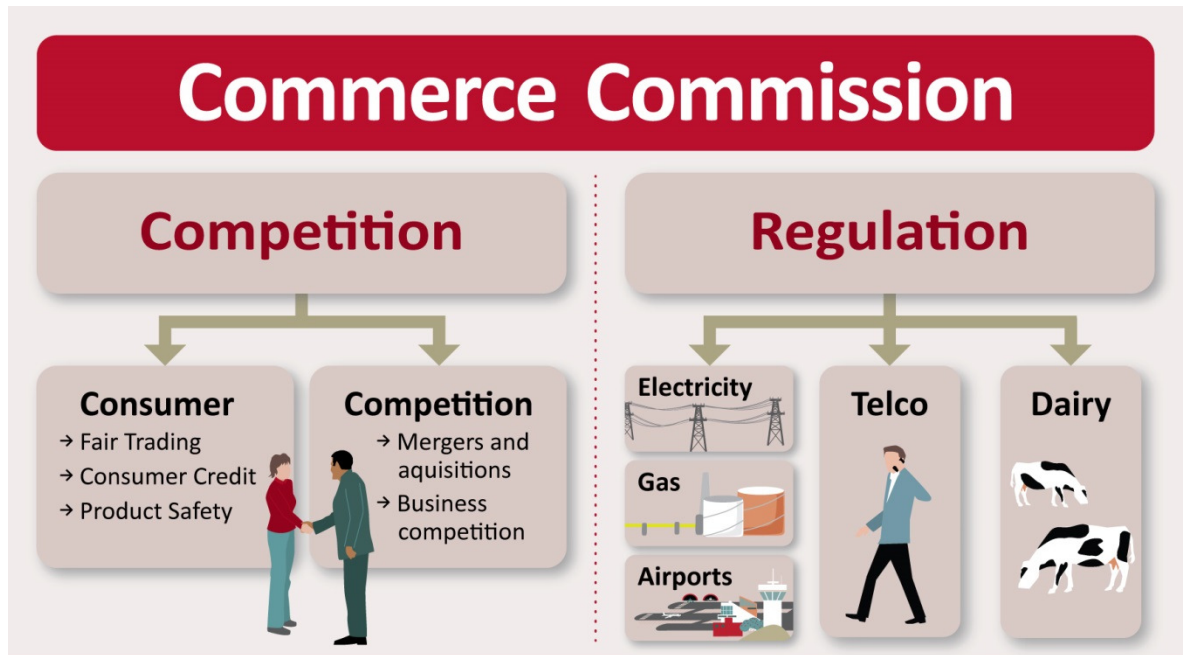
Introduction

The role of a competition authority

8. Competition regimes around the world are a key driver for delivering greater productivity and growth in the economy. Effective competition brings a choice of products and services at a price and quality demanded by consumers. It also incentivises innovation and rewards more efficient producers.
9. Through regulation we can mimic these competitive outcomes in markets with no competition.
10. An effective competition agency and regulator helps to ensure:
 - 10.1 There is a level playing field for competitors. The rules are known and players are monitored
 - 10.2 Market power is not abused
 - 10.3 The level of competition in a market is not substantially lessened by amalgamation
 - 10.4 Prices are set by effective competition or regulation
 - 10.5 Consumers are protected
 - 10.6 Regulated businesses face incentives to perform, invest and provide long-term benefits for consumers
11. There is growing evidence from around the world of the economic benefits that a strong competition regime can bring. For example in the area of cartels (agreements

or understandings between competitors not to compete with each other, such as price fixing) a recent World Bank compilation of research findings found strong enforcement not only increased detection but reduced the rate of cartel formation by almost 60% in the USA. Once cartels were broken up it resulted in price decreases for consumers by between 20 and 40 percent.¹

Our role and what we do



12. Around the world competition and regulatory agencies take a variety of different shapes and structures. Some jurisdictions have combined competition, consumer and regulatory functions while others have multiple different agencies across the functions. In New Zealand, the Commerce Commission is the combined competition, consumer and regulatory agency. This structure works for New Zealand, allowing economies of scale and supports our ability to attract high quality employees.
13. Our purpose is to achieve the best possible outcomes in competitive and regulated markets for the long-term benefit of New Zealanders. We seek to achieve the following for New Zealanders:
 - Markets are more competitive and consumers' interests are protected.
 - The performance of regulated suppliers and markets provides long-term benefits for consumers.

Competition

14. As a competition authority, the Commission enforces, and provides information and guidance on, three key pieces of legislation:

¹ *Competition Policy, Viewpoint - The World Bank Group, note number 331, September 2012.*

Commerce Act 1986 (Parts 2 and 5)	Fair Trading Act 1986	Credit Contracts and Consumer Finance (CCCF) Act 2003
Prohibits anti-competitive behaviour and acquisitions that substantially lessen competition in markets.	<p>Prohibits false and misleading behaviour by businesses. It also specifies when consumers must be given information about certain products and promotes product safety.</p> <p>The Act was amended in late 2013 to include new provisions such as substantiation and unfair contract terms.</p>	<p>Covers consumer lending, consumer leases and buy-back transactions. It requires lenders to disclose certain information to consumers when they enter into a credit contract and sets out rules about interest, payments and credit fees.</p> <p>This Act was amended in 2014 to include new provisions such as Lender Responsibility Principles and repossession rules. Most new provisions come into effect in June 2015.</p>

15. We play a key role in promoting competition and ensuring consumers are well informed and protected. Through our work, we seek to improve compliance with competition and consumer laws. This ensures businesses undertake fewer anti-competitive mergers and trade practices, allowing markets to function more competitively. It also ensures that businesses represent goods and services more accurately, allowing consumers to make better-informed purchasing decisions.
16. Under Part 2 of the Commerce Act the Commission:
 - 16.1 investigates coordinated conduct (often referred to as cartels) where individuals or organisations have entered into agreements that substantially lessen competition in a market, or exclude or limit dealings with a rival, or fix, maintain or control prices. If the Commission finds sufficient evidence we take legal proceedings against those involved.
 - 16.2 investigates cases of unilateral conduct where a person or business takes advantage of their dominant position in a market for an anti-competitive purpose or specifies a minimum price at which its goods or services can be sold by another (resale price maintenance).
17. Under Part 5 of the Act the Commission runs:

- 17.1 a clearance scheme for acquisitions where organisations who wish to enter into an acquisition or merger can be granted a clearance from the Commission. This will only be granted where we are satisfied that the proposed acquisition will not have or would not be likely to have the effect of substantially lessening competition in a market.
- 17.2 an authorisations scheme where organisations that wish to enter into an agreement or merger that leads to anti-competitive outcomes can apply for an authorisation. Authorisation will only be granted if the transaction could lead to sufficient public benefits that outweigh the competitive harm. The Commission will only grant this where we are satisfied that it will likely benefit New Zealand.
18. The Commission enforces and promotes the Fair Trading Act and the Credit Contracts and Consumer Finance Act. We run an extensive advocacy campaign to ensure that both traders and consumers are aware of their obligations and rights under the Acts. The Commission investigates potential breaches of the Acts and utilises a range of enforcement tools including compliance advice letters, warnings and prosecutions through the courts.

Regulation

19. As a regulatory agency, the Commission has responsibility under three key pieces of legislation:

Commerce Act 1986 (Part 4)	Telecommunications Act 2001	Dairy Industry Restructuring Act 2001
Part 4 provides for the regulation of price and quality of goods and services in markets where there is little or no likelihood of a substantial increase in competition.	Regulates the supply of telecommunications services in New Zealand.	Promotes the efficient operation of dairy markets in New Zealand by regulating the activities of Fonterra to ensure New Zealand markets for dairy goods and services are contestable.

20. We play a key role in regulating markets where competition is limited and there is little prospect of future competition. When competition is limited, there is the risk that consumers are overcharged or do not receive the appropriate quality of service that they would expect in a competitive market.
21. Under Part 4 of the Commerce Act, we have regulatory responsibility for suppliers of electricity lines and gas pipeline services (distribution and transmission) and

specified airport services (at Auckland, Christchurch and Wellington International Airports). Our responsibilities for these regulated industries include:

- 21.1 administering an information disclosure regime (for all services)
 - 21.2 setting and enforcing price-quality paths (which specify maximum revenue or maximum prices, and quality standards) for gas pipeline services, non-consumer-owned electricity distribution services and Transpower
 - 21.3 approving major capital investments in the national grid by Transpower
 - 21.4 setting and reviewing input methodologies (upfront regulatory rules and processes) for all regulated services
 - 21.5 conducting inquiries under Part 4 into whether particular goods or services should be regulated or controlled, and making recommendations to the Minister.
22. The Commission administers the Telecommunications Act. Under the Act, we make determinations on designated access and specified services as well as undertaking costing and monitoring activities.
 23. Under the Dairy Industry Restructuring Act, we have both enforcement and adjudication roles in relation to Fonterra's obligations in certain domestic dairy markets. We also have responsibilities to monitor Fonterra's approach to setting the base milk price paid to its suppliers.

Who we are – Organisation overview

Our structure

24. The Commission has two operational branches – Competition and Regulation – supported by the Organisation Performance Branch. Each branch is led by a General Manager who reports to the CEO, who is accountable to the Board.
25. The Commission has offices in Wellington, Christchurch and Auckland and at the end of the 2013/14 year had 178 employees (full-time equivalent). The chief executive is responsible for managing the Commission's operations, supported by the senior leadership team.

The Board

26. The Board is made up of Commission Members, appointed by the Governor-General on the recommendation of the Minister of Commerce and Consumer Affairs. The Telecommunications Commissioner is appointed on the recommendation of the Minister for Communications and Information Technology. Associate Commissioners are appointed by the Minister of Commerce and Consumer Affairs. Commission

Members have both governance and decision-making roles in exercising the Commission's powers and functions. At least one Commission Member must be a barrister or solicitor.

27. The Governor-General may also appoint up to two Cease and Desist Commissioners who must be barristers or solicitors. These Commissioners are appointed for the sole purpose of hearing and determining applications for cease and desist orders.
28. The Commission currently has the following members:
 - 28.1 Dr Mark Berry (Chairman)
 - 28.2 Sue Begg (Deputy Chair)
 - 28.3 Dr Stephen Gale (Telecommunications Commissioner)
 - 28.4 Pat Duignan (Commissioner)
 - 28.5 Elisabeth Welson (Commissioner)
 - 28.6 Anna Rawlings (Commissioner)
 - 28.7 Dr Jill Walker (Associate Commissioner)
 - 28.8 The Hon. Sir Bruce Robertson and Michael Behrens QC are Cease and Desist Commissioners.
29. We have an external convenor for our Audit, Finance and Risk Management Committee – Fred Hutchings. Fred was a partner with PricewaterhouseCoopers and is currently President of NZICA and Vice President designate of Chartered Accountant Australia and New Zealand.
30. Profiles of Commissioners and the senior leadership team are available in Attachments 2 and 3.

Governance - accountability and independence

31. We are an Independent Crown Entity with some quasi-judicial functions established under the Commerce Act.
32. We are primarily accountable to the Minister of Commerce and Consumer Affairs for our performance. We are not subject to direction from the government in carrying out our enforcement and regulatory control activities. This independence requires us to be an impartial promoter and enforcer of the law.
33. Where relevant, we use our experience to provide advice on policy development and legislative reviews. The Commission provides independent advice to Government about implementation issues that arise from any legislative changes to the Acts it has

responsibility for. It also provides advice to the Minister for Communications and Information Technology about the scope of regulation of telecommunications.

- 34. The Commission provides regular performance reports to our monitoring departments tri-annually.

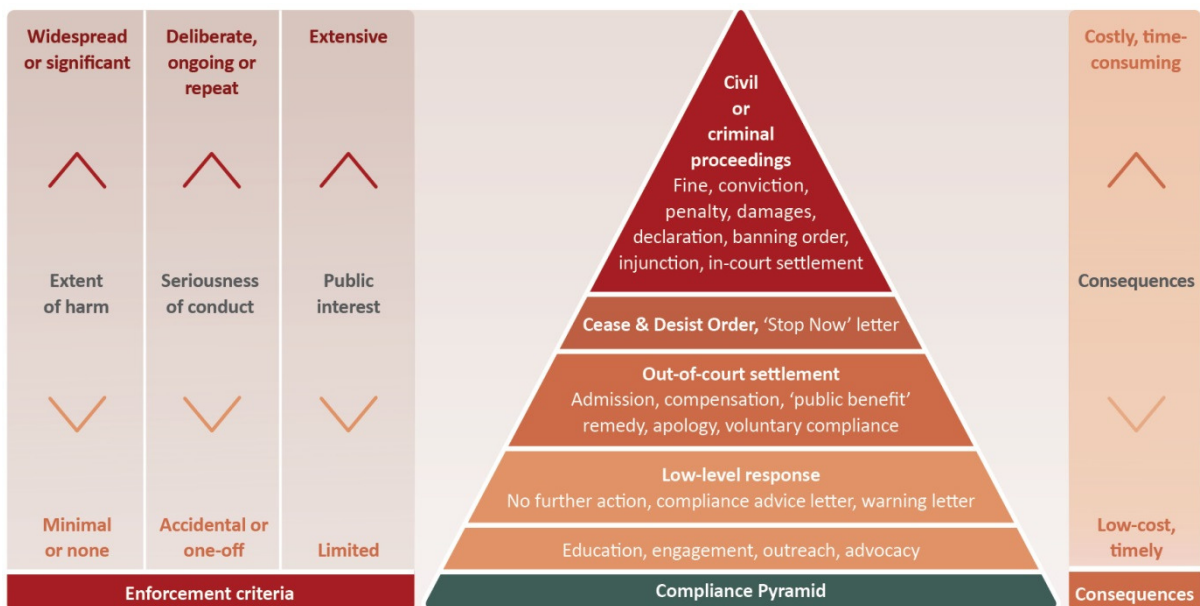
Competition

- 35. In the Competition area we prioritise our work to ensure that we take the cases that have the greatest impact and address the greatest harm. We use our enforcement criteria (shown below) as a framework when making decisions on whether to open an investigation, and what enforcement action to take at the end of an investigation. We work hard to educate businesses and consumers on their rights and obligations, and monitor and approve merger clearance applications. When businesses do not comply, we consider more serious action, including negotiated settlements or prosecutions to seek compensation for affected consumers.
- 36. A key priority for the Commission is protecting vulnerable consumers – targeting conduct aimed at vulnerable consumers. This includes advocacy, education and taking enforcement action where appropriate to do so.
- 37. Over the last three years we have obtained penalties of \$55.4 million and compensation for affected consumers of \$72.9 million.

Key achievements

Commerce Act

- 38. Cartel behaviour remains a focus of our investigation work coming to our attention either through our cartel leniency programme or through our own detection. We are continuing to see an increase in domestic cartel investigations. This is likely due to a



number of factors: our efforts in educating about cartels; the publicity about a number of successful cases; intelligence gathering efforts by the Commission; and the potential criminalisation of cartel behaviour. Examples of recent successful cartel cases:

- 38.1 In March 2014 Carter Holt Harvey was fined \$1.85 million for price fixing with Fletcher Distribution Limited in the Auckland commercial timber market. A former manager, Dean Dodds, was fined \$5,000 for his involvement.
 - 38.2 The long running air cargo cartel case was concluded last year when we settled with the final airline – Air New Zealand – almost five years after we first filed proceedings. Overall, the case achieved penalties of \$42.5 million across 11 airlines and an additional \$3 million in costs.
 - 38.3 The freight forwarding cartel case also concluded last with the High Court awarding fines of \$3.1 million against Kuehne + Nagel who was the last of six freight forwarding companies charged with breaches of the Commerce Act in 2007.
39. In October 2013 we issued Sky Network Television Ltd (Sky) with a warning as we believe that certain provisions in Sky's contracts with telecommunications retail service providers are likely to have previously breached section 27 of the Commerce Act. Currently those provisions are unlikely to have the effect of substantially lessening competition and are unlikely to cause harm in the future. We decided to take no further action at this time in relation to the historical breaches. However the Commission has put Sky on notice that it will continue to monitor Sky's contracts and conduct. A significant factor for us not taking action in the Sky case was our view that this market was in a state of flux and entry by other pay TV providers was likely. It appears that our view was correct, as reflected in the proposed paid TV offering of Spark, the growth in Coliseum's offerings, and the increasing availability of content through other channels.

Mergers and acquisitions

40. In the 2013/14 year, we received 15 merger clearance applications, the highest number of applications we have received since 2007/08. This may reflect an increased confidence in the economy.
41. In the last few years, the competition issues raised in applications have become more complex with more involving global markets.
 - 41.1 The Baxter International / Gambro AB matter decided in July 2013 was a large global merger that included divestment proposals and required considerable coordination with other jurisdictions.
 - 41.2 Domestically, the Telecom spectrum clearance determined in May 2014 concerned a complex market.

Fair Trading Act

42. In the Fair Trading area we reached a settlement with five companies including Forsyth Barr and Credit Agricole in December 2012 for alleged breaches of the Fair Trading Act for the marketing and selling of the Credit SaLLS investment product. The settlement resulted in almost \$60 million being returned to investors.
43. We have recently brought a number of successful prosecutions against businesses and individuals who have targeted vulnerable consumers:
 - 43.1 three businessmen who were convicted and ordered to pay \$140,000 for promoting a pyramid selling scheme in South Auckland.
 - 43.2 a vehicle finance company was prosecuted for misleading claims regarding the repossession of cars used as security for its loans.
 - 43.3 a company (Love Springs) was selling water filters door-to-door to people in disadvantaged areas telling them local drinking water could cause cancer and have a bad effect on their health. After preying on their fears, the company then sold its water filters at a cost of \$1,600 each. The Commission took Love Springs and its director to court, and fines of \$555,000 were imposed. After initially appealing, both the director and the company later withdrew their appeals. Finance company Tiny Terms was fined \$77,200 for its part in the sale of water filters by Love Springs.
44. The Commission has become increasingly concerned about the prevalence of misleading headline claims in advertising, especially online, where bold headline statements are made but they are then undermined by terms in the fine print. So when carpet manufacturer Godfrey Hirst appealed to the Court of Appeal in their case against Cavalier Bremworth NZ regarding misleading 'headline' claims, the Commission sought the leave of the Court to intervene in the hearing. The Court of Appeal granted the Commission's request to be heard.
45. The Court of Appeal allowed Godfrey Hirst's appeal, and those parts of the High Court's judgment that are inconsistent with the Court of Appeal's decision have been set aside. We are pleased to have the guidance that this judgment provides, which we think sets clear rules for traders and goes a long way to ensuring New Zealand consumers are protected from misleading trade practices.

Consumer Credit

46. In the area of credit advocacy we have:
 - 46.1 an ongoing programme of lower-tier lender visits to check they are complying with their disclosure obligations

- 46.2 translated our guidance materials on the CCCF Act into Maori, Samoan, Tongan and Chinese
 - 46.3 worked on guidance for lawyers that provides advice on buy-back schemes under the CCCF Act
 - 46.4 appointed a dedicated credit advocacy adviser, whose role is to help us connect with the community, gather information and develop strong connections with NGOs and other consumer stakeholders to help spread our messages among vulnerable communities
 - 46.5 started a series of roundtable events designed to increase engagement and develop a community of interest in consumer credit markets. The first focused on community organisations and was held in South Auckland in July.
47. We issued stop now letters to finance companies repossessing, or asserting a right to repossess, consumer goods where the applicable loan contracts do not provide them with a right to do so. The Commission also settled with Baycorp during the 2013/14 year in relation to practices that may have been in breach of the company's obligations under the Credit Repossession Act. As a result over \$4 million was credited to customer accounts or refunded.
48. We were also involved in the Credit Contracts and Financial Services Law Reform Bill, which strengthens consumer protection in relation to credit contracts. This Bill was passed on 6 June 2014 and almost all of its provisions will come into effect on 6 June 2015. We worked with officials to contribute to effective legislation that will ensure consumers are protected, and we continue to work with officials as the Responsible Lending Code is developed.
49. We took a test case to the High Court regarding provisions for charging fees under the CCCF Act. The High Court endorsed our decision that the fees charged by MTF Sportzone were excessive, providing greater clarity around these provisions. The decision has been appealed, and once this is finalised we will undertake some work with the finance industry about the law including the new amendment acts.

Targeting our efforts at consumer harm

50. The Commission has put in place a new risk-based approach in our intelligence unit to target the high-risk sectors and those who cause the greatest levels of consumer harm. The unit is collecting data from a wide range of sources and putting that together with the Commission's information to develop an evidence-based assessment of consumer harm in New Zealand. Each year this assessment will identify the sectors, industries and traders that are causing consumer harm through non-compliance. It will allow us to focus our limited resources to areas where we can have maximum impact, and protect vulnerable and disadvantaged consumers.

51. The assessment is not about finding matters to investigate and prosecute; it is about taking a holistic approach to prioritising our work. We will use the assessment as a planning tool to align our work programmes - screening, case selection, education and advocacy – to areas of greatest need. We may choose to use existing tools, including prosecution, or be required to design new interventions to ensure we have the necessary impact.
52. The unit has already collected information from nine organisations, including the Ministry of Business, Innovation and Employment, The Insurance and Savings Ombudsman, The Banking Ombudsman, Financial Services Complaints Limited, the Federal Trade Commission and Consumer NZ.
53. While this work has only just begun, our goal over coming years is to be offering a country-wide assessment of consumer harm.

Key challenges ahead

Law reform

54. We will continue our work to prepare for changes under the Commerce (Cartels and Other Matters) Amendment Bill by updating all cartel policies, processes and guidance in readiness for criminalisation. As part of our preparations we have published draft competitor collaboration guidelines for public consultation. We have also met with a number of key external stakeholders (including the shipping industry) to discuss the implications of the provisions in the Bill relating to collaborative activities.
55. The Commission is aware of our important role in upcoming changes to the CCCF Act. As part of this significant reform programme we will provide input to officials, educate the public on the changes, and implement systems and process changes to ensure we use and enforce these new laws in a way that ensures maximum benefit from the changes.
56. The changes made to the Fair Trading Act as part of a package of consumer law reform have provided the Commission with new powers and tools. We are focused on ensuring that we use these wisely and effectively to prevent and address consumer harm.
57. Section 36 of the Commerce Act makes it illegal for any business with a substantial degree of market power to take advantage of that power to deter or prevent rival businesses from competing effectively. The Commission's enforcement programme under section 36 of the Commerce Act continues to be constrained by practical difficulties in applying the legal tests set down by the courts. The Commission believes that section 36 is in need of reform and welcomed the previous Government's decision to review section 36 as part of its Business Growth Agenda. Given the context of the Productivity Commission's recommendation of a review and

the ongoing review of competition policy in Australia by the Harper Inquiry (which also recommends reform in its draft report), such a review in New Zealand is timely.

Continuing successful enforcement

58. This year we have seen unprecedented appeal activity in the Fair Trading area. We have successfully defended each of them. Such challenges and appeals to our processes or outcomes are (potentially) costly and can significantly impact our work programme.
59. Our Fair Trading Act case against three major banks in relation to interest rate swaps sold to farmers is likely to be our last major case in the financial sector. Going forward, cases like this are likely to be taken by the Financial Markets Authority (FMA) as part of changes made under the Financial Markets Conduct Act. The Commission has an MOU with the FMA.

Allocation of resources

60. We aim to target our resources effectively by focusing that resource on areas where harm is the greatest. One of the challenges relating to this is ensuring that we are able to resource new and competing demands. For example, the new powers and tools we acquired as part of the package of consumer law reform require resource to implement. The new authorisation process under the reform of the Commerce Act will also require resource to implement. We also face new calls on our resources from other areas such as the Ministry of Foreign Affairs and Trade for capability building in relation to Free Trade Agreements.
61. Our work programme in compliance and enforcement is somewhat discretionary in that we prioritise and choose what to focus on. But our merger and authorisation work is non-discretionary and must be completed in all instances.
62. We need to make prioritisation decisions on a regular basis to manage these conflicting demands. For example, if a large scale authorisation were to be received, it would likely significantly affect our work programme, potentially meaning we would need to put a temporary hold on other work in the Competition Branch.

Regulation

63. We are focused on providing incentives for suppliers for regulation to deliver outcomes that are for the long-term benefit of consumers. As part of this we aim to provide regulatory predictability to support incentives to invest. We work to ensure that prices are as reflective of costs as possible while ensuring that there is an appropriate level of investment. This is an area that will always create a tension between industry and consumers. We also provide public commentary on the performance of suppliers and, undertake compliance and enforcement activities.

64. We have three key work areas in regulation:
- 64.1 Part 4 – natural monopolies regulated under Part 4 of the Commerce Act. These include Transpower, electricity distribution, gas pipelines and airport services
 - 64.2 Telecommunications
 - 64.3 Dairy

Key achievements

Input methodologies

65. Input methodologies are the range of upfront regulatory rules, processes and requirements set by the Commission under Part 4 of the Commerce Act. These cover matters such as the valuation of assets, the treatment of taxation, the allocation of costs, and the cost of capital, and apply to some key infrastructure businesses where there is little or no competition such as electricity distribution, gas pipelines and airports (Wellington, Christchurch and Auckland). Since input methodologies were first set by the Commission in 2010 we have been through three years of litigation which culminated in a High Court decision in December 2013.
66. The Court ruled in favour of the Commission on all but two minor points out of at least 58 challenges. The Major Electricity Users Group (MEUG) sought to appeal one point (cost of capital range), but leave was declined by the Court.
67. The litigation process has rigorously tested the merits of the Commission's decisions. We now have significantly increased predictability for investors, suppliers and consumers in the electricity lines, gas pipelines, and airports sectors.

Implementation of Part 4

68. The regulatory instruments created under Part 4 are now fully in place. This includes the establishment of input methodologies, price-quality paths, and information disclosure requirements.
69. This has been a major process of implementation since legislation was passed with cross-party support in 2008. We are now in a new phase of ongoing incremental improvement in the regime with a focus on ensuring that we have effective incentives in place to deliver long-term benefits for consumers.

First customised price path

70. In 2013 we received our first application for a customised price path (CPP) proposal from Orion. As a result of the Christchurch earthquakes, Orion's circumstances had materially changed, and they applied for a CPP to address the extra costs incurred and investment now required. The final decision allowed Orion to increase prices by up to 8.4 percent from 1 April 2014, just over half of what they had originally

requested. Further annual increases at CPI plus one percent will be allowed until 2019.

Section 56G airports reports

71. The Commission has provided three section 56G reports to Ministers on the effectiveness of information disclosure as a form of regulation for the three international airports (Auckland, Wellington and Christchurch). The reports found that information disclosure was only effective in constraining Auckland Airport from planning to achieve excessive profits.
72. After the release of our reports, Wellington Airport reconsidered its pricing in order to comply with the input methodologies. The Commission will review Wellington Airport's revised prices and provide supplementary advice to Ministers to assist and inform any future decisions about future regulation in the airport sector. Christchurch airport has also indicated a willingness to review its prices during the next price-setting process.
73. The three section 56 reports have been provided to the Ministers of Commerce and Transport. MBIE and the Ministry of Transport will be leading the policy response, and we are happy to work with officials on this. MBIE have released a consultation paper on the airports information disclosure regime.

Key challenges ahead

UBA/UCLL final pricing principle

74. The major focus for the telecommunications group in the rest of this financial year will be completing the resetting of Chorus's wholesale broadband prices, the unbundled copper local loop (UCLL) price, and unbundled bitstream access (UBA) price. The resetting involves modelling the replacement costs—in New Zealand—of the relevant facilities. We plan a draft decision this December and a final decision by April 2015.
75. In 2011 in order to participate in the Ultra-fast Broadband initiative, Telecom became the first 'incumbent' telecommunications company in the world to undergo a structural separation. The business was separated into two parts, each listed on the stock exchange – Chorus (the network operator and wholesaler) and Telecom (the retail business and mobile network operator).
76. This separation of Telecom resulted in a number of regulatory tasks including setting new wholesale prices for UBA services.
77. The price setting exercise has been a two stage process. The first stage involved setting the current broadband prices last year by international benchmarking. This is a methodology required by the 2011 legislation. The process we went through to set

the benchmarked price was recently endorsed by the High Court and Court of Appeal after appeals by Chorus.

78. For the second stage we have been required to recalculate the price using a full cost model following requests from Chorus, Spark, Vodafone and others. This is a complex and challenging exercise.
79. The price setting process has been contentious because:
 - 79.1 The wholesale broadband price was set on a “retail minus” basis before separation and the effect of legislating the price to international benchmarks was not fully anticipated by a number of parties. The international benchmark prices were significantly lower than the retail minus approach used by Telecom before separation.
 - 79.2 It appears that market analysts have assumed that we would have more discretion than we do (based on their experience in other jurisdictions)—to adapt pricing principles to government policy priorities.
 - 79.3 Current copper broadband prices may not provide a strong incentive for migration to the government-backed UFB, and previous prices were associated with a restructuring of Chorus’s obligations and finances.

Review of the Telecommunications Act

80. The Commission looks forward to contributing to the review of the policy framework for regulating telecommunications services as an expert participant. We will be providing our assessment of the effectiveness of the current regime that we are responsible for applying. We are committed to assisting in any way we can to an overall improvement of regulation in the sector.

Broadband Monitoring

81. A new appropriation of \$1.2 million has been established to trial a new approach to broadband performance monitoring based on a methodology being developed by the Telecommunications Carriers Forum (TCF) in support of the Forum’s Product Disclosure Code. The appropriation is for one year, and will be funded from a fiscally neutral technical transfer from 2013/14.
82. We can begin this work once the TCF has agreed on the specifications for this project and they have been endorsed by the Minister of Communications.
83. We will continue to work with MBIE and the sector to progress this once the technical requirements have been finalised and the costs and testing options are better understood.

Weighted average cost of capital (WACC)

84. While MEUG’s application to appeal the High Court judgment in the input methodologies case on the cost of capital range was declined, the judgment in that

case included a comment that the choice of the 75th percentile may be at odds with the objective of Part 4 to limit the ability of suppliers to earn excessive profits.

85. As a result of the uncertainty created by the High Court comment, the Commission issued a notice of intention to do further work on the WACC estimate. We also received submissions from consumer stakeholders (including major corporates) requesting that we undertake the work. The WACC is used in the price-quality path and information disclosure regimes for regulated businesses.
86. In July, we released our draft decision on the WACC proposing a reduction to the 67th percentile rather than the 75th. This draft is now open for consultation and we will issue our final decision in October. The final decision will affect the prices electricity lines businesses can charge from April next year, and from 2017 for gas pipeline businesses.
87. The proposed change in the WACC percentile would reduce consumer bills by about \$33m per year² across both electricity lines and gas pipeline services, without compromising efficient investment or service quality. At the same time, regulated businesses subject to price-quality paths would see their rate of return reduce by about 24 – 28 basis points per annum. The decision aims to strike the right balance to ensure on-going investment while constraining excessive profits.

Electricity

88. Price-quality regulation is designed to ensure that electricity distribution and transmission companies have similar incentives and pressures to suppliers operating in competitive markets to innovate, invest, and improve their efficiency. It also aims to limit the ability of suppliers to earn excessive profits, while also ensuring that consumer demands on service quality are met.
89. The next five year regulatory period for 17 electricity distributors (EDBs) and Transpower starts in April next year. We have issued draft decisions for price-quality paths for consultation and final decisions are due in late November.
90. For electricity distributors, the proposed price limits outlined in the draft decision would see prices across the industry decrease by a small margin from 2015 (although some regions would have increases). The price changes we announce in our final decision in November may differ from the draft decision following our consideration of submissions.
91. Transpower is expected to have relatively modest increases in its revenue between 2015 and 2019. Over this period, Transpower's revenue is predicted to increase by about 4-5%, with an initial decrease in 2015 resulting from the likely reduction in the WACC rate and then gradual increases from 2016. Transpower's revenue is flattening

² calculated on a post-tax basis

off as it enters more business as usual operations following its major build programme.

92. Within the regulatory period, we will be considering applications to approve a small number of major capital projects from Transpower and any applications for a customised price-quality path from electricity distributors.
93. In addition to new major capex project approvals, we will be considering applications to amend existing approvals. This includes reviewing Transpower's expenditure on the North Island Grid Upgrade Project. The project was completed in October 2012 at a project cost of \$894 million, \$70 million above the maximum approval amount. We expect to make our decision by August 2015.

Gas pipelines

94. Price-quality paths are not due to be reset for gas pipeline services until 2017.

Dairy

95. In dairy we are focusing on providing input into the Government's review of the dairy industry. We have liaised with officials about the role we may play in the review required under the Dairy Industry Restructuring Act. We see our role as not promoting a particular outcome but to actively participate and assist in the review in whatever way we can.

Capability and Resourcing

Our people

96. We know we can only achieve our goals if we have the right people, leadership and tools to do our jobs. We have a positive work culture and have a high level of employee engagement. To ensure we have the capability to achieve our outcomes, we aim to attract, develop and retain high-calibre people. The Commission team includes people with backgrounds in economics, finance, engineering, business and law, and with a mix of both private and public sector experience.
97. We run an annual employee engagement survey to gather feedback from our employees and ensure we continue to improve. Our most recent survey in 2014 demonstrated on-going improvement in our engagement scores, we moved from middle of the state sector benchmark group three years ago to having the fourth most engaged state sector workforce this year. We are committed to continuing to improve by working with our employees to identify and respond to opportunities to make the Commission a great place to work.

Financial resourcing for 2014/2015

98. The Commission is very focused on using sound financial management to deliver on our objectives and to ensure that we have the resources to take the cases that are most important to New Zealanders.

Funding

99. The Commission is funded in 2014/15 through seven different appropriations across two Votes; Vote Commerce and Consumer Affairs, and Vote Communications.
100. Attachment 1 details the funding method, and revenue and expenditure for each appropriation for 2014/15. Further financial information is contained in the Commission's 2014/15 Statement of Performance Expectations and 2013/14 Annual Report.
101. In the 2013/14 year we received approximately 51% of our income directly from the Crown, 42% ultimately funded directly by regulated industries through levies, and 7% of our income came from interest revenue, determination applications, and cost recoveries.
102. The Commission's operating expenditure budget for 2014/15 is \$41.584 million (GST exclusive).

Funding reviews

103. Funding reviews have been completed for many of our areas of activity in recent years.
104. We will work with MBIE on a review of funding for our Dairy Industry Restructuring Act responsibilities which was originally scheduled to be completed by December 2014.
105. There have been no baseline increases for our general markets, and Telecommunications responsibilities since 2005/06.

Sustainable operations

106. Despite not having received increases in funding in most work areas for almost 10 years, we have continued to find efficiencies and ensure that our operations remain financially sustainable over the medium term. We have done several things to reduce our costs and improve efficiency – restructuring the organisation, revised processes and providing services to the Electricity Authority.
107. We need to make prioritisation decisions on a regular basis to manage the conflicting demands of our work programme and emerging issues. Over the next few years we will also need to make trade-offs to manage our work priorities within our current level of funding.

108. The Commission continues to manage a variety of funding and cost pressures. The key pressures include:
- 108.1 recent Consumer Law Reform legislative changes. These changes have had and will continue to have an effect on the Commission. We face costs associated with educational materials and ensuring consumers and traders were aware of the changes. However, the largest cost pressure will be in our extended remit for enforcement through the introduction of provisions such as unfair contract terms, substantiation and uninvited direct sales.
 - 108.2 amendments to the CCCFA which will come into force in June 2015. We will face education costs similar to those under Consumer Law reform and we will also face costs associated with our extended remit in terms of lender responsibility and repossession.
 - 108.3 the passing of the new cartel criminalisation legislation and, in particular, the collaborative activity clearance regime. This legislative change may result in a significant increase in non-discretionary workload. We are also seeing a trend indicating an increase in the number of merger clearance applications involving more complex issues.
 - 108.4 part 4 inquiries. We may need to conduct one or more Part 4 inquiries in 2014/15 and 2015/16. As we are not able to use levy funding for this work we may need to use reserves to fund these inquiries.

Reserves

109. The Commission actively manages its reserves to minimise risk to the Crown. We ensure that we maintain reserves at a level which allows us to manage our litigation and other financial risks. These risks are diverse and often involve a large amount of unanticipated expenditure in a relatively short timeframe. In particular, large litigation cases can create significant potential risks, so we must hold enough reserves to allow us to take cases we believe are important for the long-term benefit of New Zealanders.
110. We regularly review our reserves levels and proactively return reserves to the Crown if they exceed the level we require. Over the last two financial years we have voluntarily returned \$5 million to the Crown.

Efficiency

111. In carrying out our work the Commission continues to look for ways to operate more efficiently and effectively by focusing on the benefits of our work to the wider economy. We carefully monitor our work programme to anticipate any significant pressures on our operating budget, and manage our costs within current appropriation levels. We have achieved savings by reviewing and streamlining our structure and activities.

Better public services

112. We continue to contribute to the Government's priority for better public services by ensuring we take opportunities to use or provide shared services with other agencies where it makes good business sense to do so.
113. We have adopted many of the initiatives within the Government ICT roadmap and will continue to assess opportunities on a case-by-case basis.
114. We have been active participants in the all-of-government procurement programme to take advantage of the government's collective purchasing power in areas such as mobile voice and data, external legal services, vehicles, travel management services and air travel.
115. We have worked cooperatively with other government agencies to ensure we achieve our goals without duplication and to share information and expertise where it is possible to increase value for money for the taxpayer. For example, we entered into a Memorandum of Understanding with the Financial Markets Authority (FMA) to clarify our respective roles around the enforcement of the Fair Trading Act in the financial sector.
116. We have also worked closely with the Electricity Authority and both agencies are making savings from the Commission providing IT services to the Authority including infrastructure hosting and helpdesk services. Also as part of our new intelligence unit, we are collecting data from other government agencies and NGOs to inform our knowledge of emerging issues and risks to consumers.

Benchmarking our administration and support costs

117. In order to monitor our efficiency, we benchmark our HR, finance, procurement, information and communications technology, and corporate and executive services functions and identify strengths and areas for improvement.
118. We continue to use the Benchmarking Administrative and Support Services (BASS) framework, although we are not one of the agencies directly involved in the programme. We aim to see an ongoing decrease in the percentage of our total organisation running costs spent on administration and support year on year, and to keep the proportion of this spend in line with the median for the BASS small agency cohort.

Key relationships

119. The Commission maintains key relationships with both government and international agencies.
120. The Commission works cooperatively with relevant government agencies to ensure that we achieve our goals without duplication or conflict, and that we share

information and expertise where required. In particular the Commission has a number of key relationships with ministries such as MBIE who have a key role in monitoring the performance of the Commission.

121. As a member of the OECD, New Zealand complies with the 1986 recommendations on international co-operation relating to the notification of investigations or proceedings to other member countries if their interests may be affected.
122. The Commission is a member of the International Competition Network (ICN) and the International Consumer Protection and Enforcement Network (ICPEN), both of which are associations of enforcement agencies. Having effective competition laws and enforcement are considered to be vital in obtaining the confidence of potential foreign investors and in attracting finance for development.
123. The Commission also has agreements with several regulatory or competition bodies in other countries. The Commission has co-operation arrangements with the ACCC, the Canadian Competition Bureau and the Taiwan Fair Trade Commission. In the United Kingdom it has co-operation arrangements with Her Majesty's Secretary of State for Trade and Industry and the Office of Fair Trading (now the Competition and Markets Authority).
124. The agencies above share information as allowed by existing privacy and confidentiality laws, co-ordinate enforcement activities where appropriate and avoid any conflict in enforcement action. The Telecommunications Commissioner also participates in regulatory round-table discussions, and staff are involved in International Telecommunications Union activities, as well as contributing to OECD development activities.

Attachment A - Commerce Commission appropriation funding, revenue and expenditure 2014/15

	Funding Method	Scope of Appropriation	Estimates Appropriation 2014/15 (\$000)	Appropriation Type: MYA, MCA, AA ³
Non-Departmental Output Expenses				
VOTE: COMMERCE AND CONSUMER AFFAIRS				
Economic Regulation of Electricity Lines Services 2014-2019 (MYA)	Levy	This appropriation is limited to the regulation of electricity lines services under Part 4 of the Commerce Act 1986 for the period 2014-2019	7,244	MYA (full 5 year appropriation: 28,311)
Economic Regulation of Gas Pipeline Services 2014-2019 (MYA)	Levy	This appropriation is limited to the regulation of gas pipeline services under Part 4 of the Commerce Act 1986 for the period 2014-2019	1,580	MYA (full 5 year appropriation: 9,684)
Economic Regulation of Specified Airport Services 2014-2019 (MYA)	Levy	This appropriation is limited to the regulation of specified airport services under Part 4 of the Commerce Act 1986 for the period 2014-2019	597	MYA (full 5 year appropriation: 2,763)
Enforcement of Dairy Sector Regulation and Auditing of Milk Price Setting	Crown Revenue / Levy	The levy component of this appropriation is limited to funding for reviewing Fonterra's milk price setting arrangements, and dispute resolution relating to and enforcement of the Dairy Industry Restructuring Act 2001 and related regulations	1,156	AA
Enforcement of General Market Regulation	Crown Revenue	This appropriation is limited to the promotion of fair trading and competitive markets through the administration, enforcement and adjudication activities of the Commerce Commission, and the internal cost of major litigation undertaken by the Commerce Commission in relation to all of its statutory functions	13,935	AA
VOTE: COMMUNICATIONS				
Enforcement of Telecommunications Sector Regulation	Levy	The regulation and monitoring of telecommunication services in accordance with the Telecommunications Act 2001	6,000	AA
Total Non-Departmental Output Expenses			30,512	
Non-Departmental Other Expenses				
VOTE: COMMERCE AND CONSUMER AFFAIRS				
Commerce Commission Litigation Funds (MCA)	Crown revenue	The single overarching purpose of this appropriation is to meet the costs of litigation activity undertaken by the Commerce Commission arising from its general market or sector specific activities		MCA
<i>Externally-Sourced Litigation</i>		This category is limited to meeting the external direct costs of major litigation activity undertaken by the Commerce commission arising from its general market or sector specific activities	7,000	
<i>Internally-Sourced Litigation</i>		This category is limited to meeting the internal costs of major litigation activity undertaken by the Commerce commission arising from its general market or sector specific activities	3,500	
Total Litigation Funds MCA			10,500	
Total			41,012	

³ MYA: multi-year appropriation; MCA: Multi-category appropriation; AA: Annual Appropriation

Attachment B – The Board



Dr Mark Berry
CHAIRMAN

Dr Mark Berry was appointed Chairman in April 2009 for a term of 18 months; this was subsequently extended to a five year term. He has been reappointed for a further five year term, which expires in March 2019. Mark is a former partner of law firm Bell Gully and former consultant with Chapman Tripp. Mark has been in practice as a barrister sole since 2002 and holds a doctorate from Columbia University, New York. He is a former member of the faculty at Otago University Law School, and is a member of the International Advisory Board at the Institute for Consumer Antitrust Studies at Loyola University Chicago School of Law.



Sue Begg
DEPUTY CHAIR

Sue Begg was appointed a Commissioner in June 2009, and in July 2010 the Minister of Commerce announced her appointment as Deputy Chair of the Commerce Commission for a four-year term. She has been reappointed for a further five year term, which expires in June 2019. Sue is an economist. Her previous roles include director of the consultancy company Impetus Group Limited, Vice-President and head of the economic advisory unit of the investment banking division of Credit Suisse First Boston NZ Limited (and its predecessor companies) and manager of the Macroeconomic Policy section at the Treasury.

Pat Duignan



COMMISSIONER

Pat Duignan was appointed in June 2009 as an Associate Commissioner and in June 2010 as a Commissioner. He was reappointed for a further year in July 2014. Pat is an economist and corporate financier. His previous roles include General Manager Finance for Telecom Corporation, Director in the Investment Banking Division of CS First Boston NZ Limited, Treasurer of the New Zealand Debt Management Office, and Director Policy Coordination and Development at the Treasury.



Dr Stephen Gale
TELECOMMUNICATIONS COMMISSIONER

Dr Stephen Gale was appointed as the Telecommunications Commissioner in July 2012. Prior to that, he was an Associate Commissioner since July 2010. He has specialised for some years in infrastructure economics and competition proceedings at the infrastructure consulting firm Castalia, and before that at the New Zealand Institute of Economic Research.



Elisabeth Welson
COMMISSIONER

Elisabeth Welson was appointed in September 2012 as Associate Commissioner and as a Commissioner on 19 August 2013. Before joining the Commission, Elisabeth was a senior commercial Partner at Simpson Grierson, where she co-led the competition and regulatory group and headed the energy, natural resources and utilities market group. She holds an LLB (Hons) from the University of Auckland and has practised as a Barrister and Solicitor in New Zealand as well as a Solicitor of the Supreme Court of Queensland and Solicitor of the Supreme Court of New South Wales.



Anna Rawlings
COMMISSIONER

Anna Rawlings was appointed a Commissioner in June 2014. She was previously a partner in the dispute resolution division of Minter Ellison Rudd Watts where she specialised in contentious and non-contentious aspects of competition, regulatory and consumer law. Anna holds a BA/LLB (Hons) from the University of Auckland and an LLM from the University of Toronto where her work was focused in law and economics.



Dr Jill Walker
ASSOCIATE COMMISSIONER

Dr Jill Walker was appointed as Associate Commissioner in November 2010. She is also a Commissioner of the Australian Competition and Consumer Commission and Chair of the International Air Services Commission in Australia. Before joining the ACCC, Jill was a member of the Australian Competition Tribunal and worked as an economic consultant. She holds a Bachelor of Arts in Economics and a PhD in Land Economy from the University of Cambridge. She also holds a Masters degree in Economics from the University of Massachusetts.

Attachment C – Senior Leadership Team



Brent Alderton
CHIEF EXECUTIVE

Brent Alderton is the Chief Executive of the Commerce Commission in New Zealand, a role he has held since January 2011. Brent joined the Commission in 2009 and held the role of General Manager Regulation immediately prior to becoming Chief Executive. Before joining the Commission, Brent gained a broad range of business experience in both the private and public sector in New Zealand. This includes a variety of finance, strategy, policy and analysis roles at organisations such as New Zealand Oil and Gas Limited, Deloitte, the Electricity Corporation, the Treasury and the Department of Social Welfare. Brent has a BA (Hons) in Economics and an MA in Political Studies from the University of Otago.



Dr John Hamill
GENERAL MANAGER REGULATION

Dr John Hamill has been the General Manager Regulation since January 2011. John had been the Manager for Airports and Input Methodologies in the Regulation Branch for the previous two years. John is an experienced manager with a strong public sector background. He previously worked at the Ministry of Justice and has demonstrable experience in strategy, policy development and organisational/sector performance. John has a PhD in English Literature from Victoria University of Wellington.



Kate Morrison
GENERAL MANAGER COMPETITION

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



Geoff Williamson

GENERAL MANAGER ORGANISATION PERFORMANCE

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