COMMERCE COMMISSION

This document should be read in view of amendments to the Commerce Act made in August 2017. The Commission will update the document in the near future to reflect changes made under the Act.

THE COMMERCE ACT

REGULATION OF GOODS AND SERVICES

This fact sheet explains why certain goods and services are regulated under the Commerce Act. It outlines the process followed by the Commission to decide whether to recommend price and quality regulation. It is designed to give both businesses and consumers a better understanding of the purpose of regulation under the Commerce Act and when it may or may not be appropriate to regulate.

WHY REGULATE?

In most markets, competition delivers benefits to consumers. Benefits include lower prices, better quality, and greater innovation. However, in limited cases, there may be little or no competition and little prospect of future competition. In these markets, the Commission may need to regulate the price and quality of goods and services for the long-term benefit of consumers.

Regulation is designed to ensure that suppliers of regulated goods and services have similar incentives and pressures to suppliers operating in competitive markets. Suppliers of regulated goods and services should not be able to earn excessive profits.

Under Part 4 of the Commerce Act, regulation must ensure that on one hand, regulated suppliers have incentives to:

- innovate and invest
- improve efficiency
- provide goods or services at a quality that reflects consumer demands.

On the other hand, regulation must also ensure that regulated suppliers have:

- incentives to keep prices down
- limited ability to extract excessive profits.

The Commission receives many complaints about high prices. High prices alone do not necessarily suggest that there is a problem with a market. For example, high prices in a market may simply be a result of high input costs and may not necessarily indicate a lack of competition.

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WHICH GOODS AND SERVICES ARE REGULATED?

The Commission regulates certain markets under either Part 4 of the Commerce Act or under specific legislation. These are set out below.

MARKET	LEGISLATION
Electricity lines services	Part 4, Commerce Act
Gas pipeline services	Part 4, Commerce Act
Airport services	Part 4, Commerce Act
Telecommunications	Telecommunications Act
Dairy	Dairy Industry Restructuring Act

Before a market can be regulated under the Commerce Act, the Commission must undertake an inquiry.

WHEN WILL THE COMMISSION CONDUCT AN INQUIRY?

An inquiry can be triggered in two ways.

- The Minister of Commerce may require the Commission to conduct an inquiry, or
- The Commission may hold an inquiry on its own initiative.

When deciding whether to hold an inquiry on our own initiative, we will conduct a preliminary assessment of a number of factors, including the levels of competition in a market (both current and future), the scope for suppliers to exercise market power, and the effectiveness of any existing regulation of that market.

We do not undertake inquiries on our own initiative lightly. Given the costs to the Commission and industry of such an inquiry, we must consider whether the likelihood of recommending regulation under Part 4 is sufficiently high to justify the cost and uncertainty associated with a Part 4 inquiry.

We also need to consider whether an alternative option is open to the Commission (or another body) that might achieve similar or better outcomes for that market more quickly or more cost-effectively.

WHAT DO WE CONSIDER DURING AN INQUIRY?

When deciding whether to recommend regulation, we must consider the level of competition in the industry and degree of market power held by existing suppliers in the market. We must also consider whether the benefits of regulation would be likely to exceed the costs, and if so, the best way to regulate those goods or services.

HOW DO WE ASSESS COMPETITION AND MARKET POWER?

We must consider the following three issues:

- whether there is little or no competition in the market; and
- whether there is any prospect of a substantial increase in competition; and
- whether the suppliers in the market are able to exercise "substantial market power".

Little or no competition or prospect of an increase in competition may exist in markets where:

- there is a single supplier for most or all of a particular market (such as gas pipelines and electricity transmission);
- there are very high barriers to entry.

Suppliers are considered to have substantial market power when they are able to raise prices (or reduce quality) and increase profit. To decide if suppliers have substantial market power, we are likely to consider:

- how much existing competition there is to the business (i.e. from existing rivals);
- how much potential competition there is to the business (i.e. whether new suppliers might enter the market if existing suppliers increase prices or lower quality);
- how much power customers are able to exert on the business (i.e. whether customers would be in a position to refuse to buy the goods or services if an existing supplier increased prices or lowered quality); and
- whether any existing regulation or ownership arrangements are effective in limiting suppliers' ability to exercise market power.

DO THE BENEFITS OUTWEIGH THE COSTS?

If we consider there is little or no prospect of competition, no likely increase in competition in the future, and suppliers are able to exercise substantial market power, we will then consider whether the benefits of regulation are greater than the costs.

It is possible that regulation might cause a loss of efficiency and innovation for regulated businesses, such as:

- increased compliance costs;
- increased uncertainty for regulated businesses, their own suppliers and downstream customers, which may discourage investment; and
- the regulated price may be set too low and this could also discourage investment.

HOW DO WE REGULATE AN INDUSTRY?

If we decide to recommend regulation, we must also recommend the type of regulation. Under the Commerce Act there are three possible types of regulation. Broadly these are:

- regulation of the prices, revenues and/or quality of the relevant goods or services;
- negotiation between the supplier and its customers on the prices and quality of the relevant goods or services; and
- requiring regulated suppliers to disclose information about their financial performance, or other aspects of business performance.

WHAT HAPPENS AFTER AN INQUIRY?

After we have completed our inquiry, we will make a recommendation to the Minister. The Minister must decide whether to regulate and if so, the best form of regulation. The Minister must publish our recommendation.

If the Minister's decision is different from our recommendation, then the Minister must publish the decision and the reasons for the decision.

To check for updates to this fact sheet visit: **www.comcom.govt.nz/regulated-industries**

This fact sheet is part of a series looking at the Commerce Act. Other fact sheets can be downloaded from **www.comcom.govt.nz/business-competition**

CONTACT

Contact the Commerce Commission with information about possible breaches of the Commerce Act.

TELEPHONE
Our Contact Centre during office hours on 0800 943 600

WRITE
To us at Contact Centre, PO Box 2351, Wellington 6140

EMAIL
Us at contact@comcom.govt.nz

PENALTIES

If the courts find an individual or body corporate has breached the Commerce Act, penalties can be heavy:

- for an individual, a maximum of $500,000; or
- for a body corporate, the greater of:
  - $10 million, or
  - three times the commercial gain, or, if this cannot be easily established, 10 percent of turnover.

Every separate breach of the Act (even if done by the same person) may incur a penalty.