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REGULATION IN NEW ZEALAND

TELECOMMUNICATIONS:

THE REGULATORY BODY'S PERSPECTIVE

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INTRODUCTION

This paper concerns the monitoring of competition in the New Zealand telecommunications sector from a regulator's perspective. New Zealand's approach to the regulation of utilities, of which telecommunications is one, sometimes called 'light handed' regulation, has attracted a lot of attention internationally. The concept of 'light handed' regulation emerged from the policy debate concerning the deregulation and privatisation of telecommunications during the period 1987-90.

To some familiar with the costs of 'heavier' forms of regulation associated with industry-specific bodies and the compliance costs visited upon regulated firms, light handed regulation may seem to offer an attractive, less economically distortionary, alternative. Others may be fearful that the approach involves regulation that is too light handed, with the result that firms with market power operate without sufficient restraint, to the detriment of their customers and to efficient production.

The New Zealand experience lies somewhere in between. The policy has had important successes for the economy. It is also still working through some unresolved difficulties. It has been in operation only about 10 years, and is still evolving and being refined. Success and failure also have to be measured against what other practical alternatives are available, recognising that all such options are imperfect, and within the rather distinctive context of the New Zealand economy. Light handed regulation in the New Zealand context is broad spectrum regulation. The Commerce Act covers almost all markets, irrespective of the industry involved, whether firms are publicly or privately owned, whether export oriented or local producers, whether utilities or not.

THE COMMISSION'S GENERAL ROLE

The Commission is an enforcement agency which seeks to bring about compliance with the Commerce and Fair Trading Acts. In respect of the Commerce Act the Commission has a role in monitoring structural changes of, and behaviour in, markets in New Zealand. Broadly, the Commission:

- attacks anti-competitive behaviour whether by groups of competing firms or by dominant firms;
- monitors “monopoly” pricing; and
- assesses business acquisitions;

Anti-competitive Behaviour

The Commerce Act prohibits restrictive trade practices (“RTPs”) which adversely affect competition. These prohibitions apply to all individuals and commercial organisations including State Owned Enterprises and government departments. RTPs include:

- arrangements, contracts and understandings between competitors that substantially lessen competition in a market (section 27)
- arrangements between competitors that reduce the competitiveness of another rival (such as attempts to exclude another competitor from a market by arranging boycotts) (section 29)
- arrangements that lead to prices being fixed among competitors (such arrangements are deemed to substantially lessen competition) (section 30)
- a company dominant in a market using its position to prevent competition in either that market or another market (section 36).

The Commission enforces the RTP provisions of the Act by court action or through administrative settlements. The penalties for a breach are significant (up to \$5 million for an organisation and up to \$500,000 for an individual) and the Courts are showing some tendency to impose higher penalties on offenders. An RTP resulting in a loss of competition can, however, be authorised in the same manner as business acquisitions provided it can be shown that the public benefit exceeds the detriments stemming from the loss of competition.

Monopoly Pricing

Part IV of the Commerce Act provides for the introduction of price control by the Government in circumstances where goods or services are, or will be, supplied or acquired in a market where either limited competition exists or competition is likely to be lessened; and it is necessary or desirable for the prices of those goods or services to be controlled in the interests of consumers. The Commission can recommend the imposition of price control or alternatively may be asked by the Government to report on the necessity or desirability of such a step. No items have yet been put on price control under the 1986 Act. However, the Commission regards this instrument as a credible part of its duties.

Business Acquisitions

Section 47 of the Act prevents any business from:

- becoming dominant in a market; or
- strengthening an existing dominant position

through the acquisition of shares or assets of a business, unless that business acquisition can be justified in terms of the public benefits resulting from the acquisition being greater than detriments arising from the acquisition or strengthening of dominance. Acquisitions which do not give rise to dominance concerns can be cleared by the Commission. The Act provides for:

- prior clearance or authorisation which protects proposed acquisitions from challenge under the Act. The clearance process examines only the competition effects of a proposal, while the authorisation process allows for approval on public benefit grounds. The only exception to this protection is by way of appeal against the Commission's clearance or authorisation decision;
- High Court action in respect of acquisitions that are anti-competitive;

Accordingly, the Commission has an adjudication role in deciding on applications for clearance or authorisation. The large number of applications over the last few years, together with several court rulings, mean this function is now very clear-cut. The Commission also undertakes surveillance to ensure that any unnotified acquisition that may lead to dominance concerns is "struck down". To date, no strike down action has been taken, but the Commission will not hesitate to apply to the Court for such action in the appropriate circumstances.

UTILITY REGULATION

In New Zealand the main regulatory issue is posed by those utilities where access to an incumbent's essential facility network is necessary for new entrants to compete in the provision of upstream or downstream services, for example telecommunications, electricity and natural gas reticulation. Such firms have an obvious incentive to preserve their monopoly power and profit by hindering access, either by an outright refusal to supply, or by setting an access price high enough to render entry unattractive.

A further group of utilities are organised around what may be called natural monopoly facilities, but are not vertically integrated. These include electricity transmission, ports, airports, water, roads, bridges and tunnels. Such utilities may have the horizontal market power to extract excess profits from the sale of the final good.

The light handed approach to the regulation of such utilities starts with the recognition, which it shares with many overseas regimes, that not all parts of an incumbent's business are natural monopolies. The central aim is to encourage competition in those related markets where entry is possible, and to ensure that entrants into those markets are not deterred by the market power of the integrated incumbent in the essential facilities services market.

The four main components which make up light handed regulation are then as follows:

- the natural monopoly and contestable elements of the incumbent firm's business are separated, if not under different ownership, at least by accounting "ring-fencing" for information disclosure purposes;
- a reliance is placed on general competition law, as expressed in the Commerce Act 1986 (the Act), under section 36 of which dominant firms must not seek to deter or to eliminate actual or potential competitors;
- industry-specific regulations require the disclosure of information designed to make transparent the operations of companies possessing market power; and
- stronger action is threatened through the provision for the introduction of price control in Part IV of the Commerce Act.

The Commission's approach has been to give competing service providers breathing space since deregulation to become familiar with the regulatory regime, and to make efforts to familiarise participants with the reach of the Act. The Commission now considers that this honeymoon period has come to end, taking enforcement action as necessary. It is now time to consider progress made in the

utilities sector since deregulation. With this in mind, I intend to discuss recent developments as they relate to telecommunications.

TELECOMMUNICATIONS

The telecommunications industry is extremely dynamic and technology driven. It has altered significantly since deregulation. New technologies such as fibre optics, cellular telephony and personal communication services (PCS) are impacting on the industry's structure. These changes have led to substantial reductions in prices and improvements in services across the sector. At the same time, the industry has been opened to competition to an extent rarely seen overseas. Currently there are 14 parties operating in the telecommunication sector registered with the Ministry of Commerce, and more are entering the markets. Two examples of recent entrants are WorldXChange and Tele Pacific Networks which announced they were introducing nation-wide toll services.

Studies of the effectiveness of the regime overall compared to alternatives overseas have tended to reflect reasonably favourably on the New Zealand approach. For example:

- New Zealand businesses have rated New Zealand's telecommunications infrastructure highest out of 49 countries in terms of meeting business requirements (The World Economic Forum: 1996);
- Telecom's consumer favourability rating is reported as having improved during the period 1993 through 1995 (Glubb: 1996);
- The New Zealand regime is reported by Professor Henry Ergas (1996) as comparing favourably with the more heavy-handed Australian regime; and
- Economists De Boer and Evans (1996) compared favourably Telecom's productivity improvements with those of British Telecom following privatisation.

In contrast, the OECD in 1995 reported mixed results during the period following deregulation. While the rate of price reduction in New Zealand compared favourably to that in other OECD countries following the signing of New Zealand's first interconnection agreement, the level of certain prices remained relatively high in comparison to other OECD countries.

The Commission is aware of the significance of the telecommunications industry both directly for residential customers, and as an important input into most business operations that is significant to their competitiveness. For these reasons it is closely monitoring behaviour in the industry, and is currently undertaking surveillance in several areas. These are outlined below.

Current Litigation

The Commission understands that there are seven competition disputes in the telecommunications sector at some stage of proceedings in the New Zealand legal system: four of these involve Clear Communications and Telecom; one involves Clear, Telecom and the Government; one involves BellSouth and Telecom; and one involves Clear appealing a Commerce Commission decision.

The actions are over interconnection (the means by which one phone company's customers can connect with another phone company's customers); number portability, bundling (where discounts are offered if customers take a combination of monopoly and contestable services); the misuse of confidential information; the "hijacking" of customers who use a base toll call provider, and the Commission's decision to allow the purchase of a shareholding in SKY by Telecom. Judgment on some of these cases may provide useful precedent for the industry.

Interconnection

The most highly profiled disputes in this sector have related to interconnection agreement prices and conditions, with access by Clear to the local telephone network of Telecom being the subject of extensive litigation. Telecom proposed terms based upon the "Baumol-Willig" rule. This rule asserts that monopolists are entitled to provide services to competitors at the same price they implicitly charge themselves, including monopoly profits.

Clear argued that the Baumol-Willig approach was in breach of section 36 of the Commerce Act. The rule was accepted by the New Zealand High Court, rejected by the Court of Appeal, and finally in 1994 sanctioned by the Privy Council, New Zealand's highest court. After a lengthy review of the ramifications of the case by officials, the Government issued a statement indicating that it would not wish to see the Baumol-Willig rule applied in future on the grounds that it would be injurious to competition. It is significant to note that the final terms agreed on between Telecom and Clear (under Government pressure) are below Baumol-Willig prices. As a result of the terms agreed upon in the Telecom/Clear interconnection agreement it is unlikely that Telecom will be able to insist on higher access charges for new entrants, and it has been argued that the Telecom/Clear agreement paved the way for future interconnection agreements.

The Commission is aware that negotiations for interconnections between parties have been very difficult given the highly contested nature of the industry, though it expects them to become easier in the future as the network of interconnections grows. The Commission is also aware of the ability of parties to resell their interconnections onto other parties. It views interconnection agreements as a vital element to competition and evidence of its implementation is an important step in the deregulation of the industry, and will continue to monitor negotiations.

As at September 1997, nine interconnection agreements have been signed.

Primary	With
Telecom	Clear
Telecom	BellSouth
Telecom	Telstra
Telecom	Saturn
Telecom	WorldXchange
BellSouth	Telstra
BellSouth	Saturn
Telecom	Compass Communications
Clear	Telstra

Number Portability

The current topical competition issue is number portability. Number portability allows customers to switch carriers without having to alter their telephone numbers, thus giving customers a choice of carrier for services. It is of particular interest to new entrants to the market to be able to port numbers for customers, and the implementation of number portability is seen as a platform on which competition will progress. All parties in the TNAG process have expressed acceptance of number portability as a general principle which will benefit competition and the consumer.

We understand that one agreement has now been reached, using the “local call forwarding” option. Other market players are currently in commercial negotiations to facilitate number portability interconnection agreements. We are, however, aware that there are delays, frustrations and complaints about non-resolution of portability issues. The Commission understands that while there is general agreement about introducing 0800 service number portability in the market, there are marked differences in views on the implementation of number portability, given the competing interests of telecommunications carriers.

The Commission is aware that different technologies and methods may be used to implement number portability, and that agreement on implementation must be reached by commercial negotiation by the parties who seek to implement those options. The New Zealand Telecommunications Numbering Advisory Group (TNAG) is the body established to deal with number portability and other numbering issues. The Commission is also aware of the significant investment required for the introduction of an advanced intelligence network system for number portability.

The Commission is of the view that unwarranted delays in introducing full number portability to the New Zealand marketplace effectively hamper competition developing in the telecommunications sector, and such delays have the potential to breach section 36 of the Act. The Commission believes that some parties involved in number portability negotiations are taking extreme positions and need to realistically reassess their positions. The Commission wishes to reiterate that it is customers who

stand to benefit from increased choice and competition. Delays in establishing workable arrangements for number portability which lead to lessened competition, whether occasioned by an incumbent unreasonably delaying agreement or entrants taking unreasonable positions precluding agreement, are harmful not only to providers, but also to consumers interests. Up till now, the Commission has been of the view that its direct involvement would be unlikely to assist the commercial process. However, the Commission will continue to closely monitor the situation and the parties' conduct, and it may change its views on involvement.

Number Ownership

The Commission views number ownership as a link between number allocation and number portability. It is a concern that the ownership of numbers may prove to be an unnecessary barrier to competition by restricting the numbers that may be ported. The Commission is of the view that unclear property rights as to the ownership and control of the New Zealand telecommunications numbering plans could be seen as impeding progress on number portability. It will monitor this carefully as well.

Telecommunications Industry Organisation

The Commission notes the recent formation of the Telecommunications Industry Organisation. Industry organisations are important bodies that can advance general interests. It has been suggested that there is the potential for breaches of the Commerce Act to occur in this forum. The Commission notes that the parties are fully cognisant of their obligations under the Commerce Act, and will expect them to act within it.

Bundling

In addition to private litigation being taken the Commission has received several complaints relating to bundling. The Commission's approach is to screen each complaint based on the facts presented in each instance. The Commission will consider the economic rationale behind each bundling activity, for example in cases where significant economies of scope are achievable instances of bundling may be justifiable.

However, where cross-subsidisation occurs, bundling has the potential to breach the Commerce Act. Generally, the Commission's view is that in cases where a monopolist discounts without pricing below cost and without predatory intention, then the effect of the discount is likely to engender price competition, and hence benefit consumers. Conversely, if a monopolist offers a discount on its contestable service which involves charging below cost, the effect of the discount may be anti-competitive with the potential for a breach of the Commerce Act.

XTRA Investigation Outcome

The Commission recently investigated complaints of alleged below cost pricing by Telecom in respect of its Internet access services business. The allegations followed the reduction in Xtra's Internet access prices for both local call access and 0800 number access in August 1996. The new prices of \$2.50 per hour and \$4.95 per hour (inclusive of GST) respectively were substantially below both Telecom's previous prices, and those charged at the time by other Internet service providers. The complaint was that Telecom must be pricing its Internet access services at below cost, particularly as Xtra's 0800 number access price of \$4.95 per hour was less than the price of around \$6.00 per hour offered by Telecom to internet service providers for its 0800 number service.

The Commission carefully assessed Telecom's conduct in terms of both ss. 36 and 27 of the Commerce Act, and in light of the important judgements by the High Court and Court of Appeal in the *Port Nelson* case. It has taken the view that, *prima facie*, Telecom's current pricing of its Internet access service in the relevant markets and its relevant contractual relationships do not breach ss. 36 and 27 of the Commerce Act. Rather, with the rapid growth in the Internet, both overseas and in New Zealand, some internet service providers, such as Telecom's XTRA, are responding to commercial opportunities.

Acquisition by Telecom of TASP's

The Commission also undertook surveillance of the acquisition of the Telecom Approved Service Providers (TASP's) by Telecom. This year, Telecom acquired Motorola (NZ) Limited (Motorola) in June, and Ericsson Cellular Limited, (Ericsson) in October. These acquisitions lead to horizontal and vertical integration in the cellular markets and consequently raised dominance concerns.

The Commission has carefully assessed whether there was any strengthening of dominance by Telecom. It has taken the view that, *prima facie*, Telecom is currently dominant in the cellular market and the acquisitions do not lead to the acquisition or strengthening of a dominant position in a market. While the Commission intends to take no further action in relation to the recent Ericsson acquisition the Commission intends to continue monitoring the cellular market. It notes that it is possible that any further acquisition in this area by Telecom could lead to a strengthening of dominance.

Fair Trading Act

The Commission has taken significant action in the telecommunications sector under the Fair Trading Act. These cases have generally involved some issue to do with the way the price of a product or service was disclosed at the retail level. For example, a recent case was taken against Ben Rumble Communication Ltd. The case involved the advertising of cellphone prices that were lower than real selling prices because extra costs that customers had to pay were not clearly disclosed. In

addition, the company misrepresented the availability of an inexpensive 'rate' plan. The Court entered a conviction, and a fine of \$8000 was imposed. The Commission has also sent numerous warnings and received several undertakings from cellphone retailers.

The Commission has noticed that where products go from being primarily marketed to businesses to being marketed to consumers, the industry does not consider the different issues this raises. This occurs particularly with the marketing of DIY products, computers and cellphones.

The core problem with cellphone advertising has been that the overall impression given about the price of the cellphone and the price and conditions that apply to the cellphone package has been misleading. Businesses need to consider the impression that a purchaser would get from the advertising. That is, is the representation false or misleading? Few businesses which advertise cellphones seem to have asked themselves this question. Extra costs and special conditions are often left out or glossed over. If this problem continues to occur then more court action will be taken by the Commission.

When the Commission takes action against an industry practice, generally that industry responds by ceasing the offending practice, and the level of compliance with the Act improves. When this occurs, the Commission then focuses its investigative resources on clarifying and enforcing the law in other areas. However, the cellphone industry is clearly not developing compliance programmes as a result of the Commission's court action. The Commission will continue to take action to ensure that consumers are not misled, that compliant traders are not disadvantaged by unfair competition, and to ensure the integrity of the Commission's warning and settlement programme.

Criticisms are sometimes made by business people that the Commission should educate before prosecuting, as businesses want to comply with the law. The Commission has undertaken a significant amount of educative work with cellphone dealers by developing guidelines, sending out warning letters, visiting traders, meeting with the TASP's, issuing statements which have been picked up by the media. However, this work has been of limited avail with this industry.

The latest guidelines for cellphone advertising are attached. The Commission will continue to promote this guideline to the industry but until an acceptable level of compliance is achieved we will also continue with enforcement action. I encourage all of you who have anything to do with the promotion of cellphones to examine the statements you are making or that are being made in association with your product or service to ensure that the representations being made are accurate.

Convergence

Convergence means the coming together of telecommunications, broadcasting, computing, information and entertainment technologies. It is already a reality, and continues to accelerate. A clearance issued by the Commission in terms of Telecom's attempt to buy a shareholding in Sky in 1995 was challenged by Clear. Clear, saying it wanted to prevent dominance of convergent markets, brought a case to the High Court against Telecom, and the Commission was joined to this action by Clear as 31st defendant. The case made by Clear was struck out by the High Court in August of this year. Clear has successfully applied for leave to appeal the decision. The matter will now go to a substantive hearing in the Court of Appeal.

The issue of convergence is of particular importance in terms of market definition. In telecommunications, the markets as traditionally defined (e.g. fixed line telephony, cellular telephony, network services and numerous others) are all being challenged by rapidly changing technology, for example personal communications services (PCS). PCS is based on the concept of an easily transportable and relatively inexpensive handset that enables connection to a global network regardless of location. The technology allows for a combination of cellular networks and cordless telephony, that is, the PCS handset is able to act as both a cellular and a cordless telephone. The Commission is planning a pro-active investigation into the effects of emerging technology on market definition, and more particularly, the effects of the development of broader product markets on current levels of market power.

A further development has been the merging of telecommunication technology with other utilities. For example, the Canadian companies, Northern Telecom and Norweb Communications announced recently that they had, in conjunction with a power company, developed technology that made it possible for internet data to be sent down electricity wires at a rate faster than existing technology allows.

In New Zealand, a development in the convergence area has been the introduction of a four month trial in Auckland, New Plymouth and Christchurch whereby several companies are offering services to consumers in the home via an electronic platform called ORCA. Services said to be available include banking, electricity account payment, fast food delivery, energy management, home security monitoring, wine purchase, control of household appliances and news and information access. The Commission is pleased to see companies actively seeking ways in which the benefits of competition may be introduced to domestic consumers, provided it does not lead to market agreements that lessen competition. We have looked at the ORCA scheme, and our preliminary view is that, as a pilot project, it does not breach the Commerce Act.

New Zealand, with its generic and enabling competition legislation that does not impose artificial boundaries between evolving and changing industries, is uniquely well positioned to see convergence develop in ways that should be advantageous to consumers.

Other Complaints

The Commission has received several complaints recently relating to the exclusion of Clear customers (who have in the past been able to access Telecom's network by dialling 059) from accessing Telecom's international toll specials; Telecom's announcement that it is to raise its monthly wiring maintenance charge from November 1997; Telecom's announcement that from 1 December it will charge for national and international directory enquiries; and the exclusion of several parties from Telecom's yellow pages. The Commission does not consider that in principle such actions breach the Commerce Act. However the Commission sees the area of directory services as an important and evolving issue and will continue to actively monitor the area.

CONCLUSION

The message I would like to leave you with today is that the Commission's role is somewhat different from that of most overseas regulatory bodies, in that the Commission enforces general legislation, for the promotion of competition as a means of increasing efficiency. The area of telecommunications is challenging to monitor and enforce due to the natural monopoly characteristics of networks, which give rise to issues of dominance and access.

Regulation in New Zealand, often called 'light handed' regulation, exists in the form of the Commerce Act, and is supplemented by industry-specific information disclosure regulations. The success of deregulation in New Zealand, to date, has been mixed. One recent study indicates that savings achieved through productivity gains in the telecommunications sector alone were somewhere between \$539 and \$655 million in the six years from 1987 to 1993. Under light handed regulation it takes time to determine industry-specific 'rules of the game'. The telecommunications sector was deregulated early on, without the splitting of transmission networks as in the electricity industry. There has been considerable investment in private agreements and litigation which should now start to bear fruit.

The Commission notes the complexity of property rights in this area. It is concerned to see private negotiation resolve those matters that impinge on new developments, especially number portability, as soon as possible, so that New Zealand consumers can be assured of getting the best package of telecommunications services practicable.

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CELLPHONE PROMOTIONS - THINGS YOU MUST THINK ABOUT

This is a guide designed to help you with your cellphone advertising. It is not legal advice and does not cover every situation that will arise with your promotions.

Are you selling the cellphone only, or are you selling the cellphone package?

- If you are selling the cellphone only, is that clear?
- If you are selling a cellphone package, is the fact that it is a package clearly disclosed?
- If you are selling a cellphone package, does the customer know what the package ties them in to and what it is going to cost?

What is meant by “clearly disclosed”?

It depends on the medium you are using, but common to all is the issue of disclosing, in terms of the package, the less attractive features as prominently as the selling points. Once you have done your advertisement, stand back and look at the overall impression from the point of view of the customer who has not bought a cellphone before. You can do that by considering amongst other things:

TELEVISION

- Size and colour of the print and the length of time it is on the screen - will the person looking at it notice it easily and be able to easily read all of it?
- Putting the conditions in the voice over.
- Making sure your offer is not changed by the conditions.
- Making sure the advertisement screen is not so busy that the conditions are not noticed.
- Using the term ‘special conditions apply’, may not be enough to explain to the customer what the package is.

NEWSPAPERS

- Size and colour of the print and where it is in the advertisement. An asterisk to the conditions may not be sufficient.
- Drawing attention to conditions with an interesting or bold heading.
- Making sure your offer is not changed by the conditions.
- Making sure the advertisement is not so busy that the conditions are not noticed.

RADIO

- Using the term 'special conditions apply', may not be enough to explain to the customer what the package is.
- Making sure your offer is not changed by the conditions.