

TUANZ TELECOMMUNICATIONS DAY
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Telecommunications Regulation and the Consumer

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It hardly seems necessary to emphasise the importance of reliable and high-quality telecommunications services to the New Zealand economy and to New Zealand businesses and families. The telephone in the home is as basic to our everyday lives as the refrigerator, though more than half of all households also have one or more mobile phones. At the same time, our appetite for new telecommunications products and services is driving and being driven by new technologies and the availability of increasing bandwidth. For businesses large and small, including the farming sector, telecommunications is essential for dealing with staff, suppliers and customers. The telecommunications industry itself is a major source of investment and employment in New Zealand and a rapid transmitter of innovation from around the world.

Regulation has a place in this picture, as a means of ensuring that New Zealand retains a competitive and growing telecommunications sector. The consumers of telecommunications services are central to the regulatory regime, and I am therefore very glad to have the opportunity to speak to you today about the way in which the telecommunications regulatory regime works to promote their interests. Regulation is concerned with inter-carrier issues rather than retail markets as such. However, the flow-on effects from regulatory decisions impacts on the quantity, quality and price of the telecommunications services available to the general public.

The driver for the regulatory regime, in the language of the Telecommunications Act, is the promotion of competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand. More and better telecommunications services will

be the result of competition between a range of providers, investing in modern telecommunications infrastructure and bringing new products to market. The regulatory regime compensates for weaknesses in the competitive environment where incumbents are vertically integrated, and are competing in related markets with new entrants. Regulation should be a spur to innovation and efficient investment by neutralizing incentives to use market power.

There are several important points to remember concerning competition in telecommunications markets. Promotion of competition is not an end in itself. The Act makes it clear that it is 'efficient' competition that is the goal. Efficient competition has to be seen in the context of the nature of telecommunications markets. These are markets which are resource-intensive, undergoing rapid change, both in technology and services, with continuing needs for substantial new investment. The importance of telecommunications services as an input for services in other markets is also a crucial factor. Competition is a process, not a situation, and this is particularly true in such a volatile industry as telecommunications.

As is generally the case with competition policy, the goal is not to promote or protect particular competitors, or particular market structures. Because of the importance in the regulatory regime of resolving access disputes, it may be tempting to think of the end-game as the resolution of disputes between carriers (who wins and who loses). That would be the wrong way of looking at it.

In the same way, the regulator isn't in the business of deciding what the industry should look like, how many players there should be, or in which segments they should compete. Those outcomes are to be left to market forces.

Telecommunications markets have a number of different dimensions. Some are geographic, such as the provision of business local voice calls in CBDs. Others are product-related, such as the fixed line and mobile markets. And others are functional, for example wholesale or retail. So the state of competition has to be looked at in each.

The beneficiaries of competition are to be end-users of telecommunications services within New Zealand. Overseas consumers aren't part of the picture. But who are the end-users?

The end-users are the ultimate consumers of telecommunications services. While in some circumstances, the carriers themselves may be the final user of a service, we are concerned with the general public.

End-users are both residential and business consumers, though with varying and sometimes conflicting requirements.

There may be different sub-sets of end-users, with different interests. A particular action may therefore have mixed effects: benefiting some users, and at the same time being negative or even neutral in its impact on others.

The Commission will need to take an overall view of end-user benefit, and consider the net benefit to end-users as a class.

Given the context, end-user benefit refers to economic interests, such as lower prices, increased quality and an improved range of services. It also includes the benefits of investment and innovation by suppliers. A more modern telecommunications network, operating efficiently and providing quality services, is in the interests of end-users.

This last point suggests of course the possible need for trade-offs. Not only do different groups of end-users have different interests, but there may be trade-offs between one interest and another. If carriers were to cut back on network investment or maintenance in order to lower retail prices, there

would be short-term gains to consumers in lower prices, but over time a loss in service levels and quality.

The Act requires the regulator to be guided by the 'long-term' benefit of end-users. There can therefore be trade-offs between different time periods. An action might deliver short-term benefits, but over time might lose those gains or offset them with negative effects.

This doesn't mean that short-term benefits should be ignored. It simply means that those benefits must be sustainable over a longer period, or at least not offset by losses elsewhere. The long-term consequences must be positive, perhaps by calculating whether the benefits exceed the costs over the relevant time period in present value terms.

Given the goal of promoting competition for the long-term benefit of end-users, how does this relate to the major regulatory functions under the Telecommunications Act?

First there is the function of resolving disputes between carriers as to access terms. I want to underline that the Commission only becomes involved at the request of one of the parties. In other words, the optimal solution is a commercially negotiated outcome. It is only when negotiations breakdown that a regulated solution is available. Even then, the parties can resume their negotiations and the regulated decision-making process will be stopped at any time if they reach an agreement.

Access disputes can relate to interconnection with Telecom's fixed network by another carrier, and interconnection with another carrier's fixed network by Telecom. Resolving these disputes in an economically efficient manner can support competition in downstream retail markets, and can promote connectivity between users of different networks. By setting interconnection prices based on costs, end-users benefit from effective price competition. Conversely, delays in resolving carrier access disputes can restrict access by the public to new technologies or to improved service delivery

products. Whatever the rights and wrongs of the access disputes between Telecom and Clear in the early 1990's, the lengthy negotiations and court battles meant that the roll-out of competing services was delayed.

Access issues can include the terms on which a carrier will be able to wholesale Telecom retail offerings. In this way, a competing carrier can round out its own service offerings, or offer enhanced services to customers through modifying or bundling the wholesaled service.

Access disputes can also cover several key competitive features of telecommunications services, such as number portability, carrier pre-selection for fixed to mobile services, national roaming for mobile operators, co-location of cellular mobile equipment at cell sites, and co-location at sites used by Broadcast Communications Limited of equipment used to provide fixed links to end-users.

The next regulatory function is concerned with the Government's social objectives in telecommunications. Those objectives were initially reflected in the Kiwi Share, and were updated and expanded last December through an agreement between the Government and Telecom. The obligations undertaken by Telecom concerning the availability, price and standard of local voice and internet service are now known in the jargon as Telecommunications Service Obligations, or the TSO.

The Commission is required to review annually whether Telecom is complying with these obligations, and to inform Telecom and the Minister of Communications if there is any significant non-compliance. If Telecom has not complied with the TSO, the amount it would otherwise be able to recover from its competitors as a contribution to the costs of the TSO can be reduced to reflect that non-compliance.

In the past, the cost of these social objectives has been met by Telecom, though Telecom's competitors have argued that they have been reimbursing some of that cost through interconnection

prices. Under the Telecommunications Act, there is a two-stage process. First, the Commission will determine the amount of the net cost to an efficient provider of meeting the TSO obligations. The net cost is the unavoidable net incremental costs to an efficient service provider of providing TSO services to commercially non-viable customers. The calculation of the net cost is complex, involving the identification of costs relating to commercially non-viable customers and of the offsetting revenues and other benefits from serving those non-viable customers. It requires an assessment of the level of efficient technology required for the TSO function, and of the valuation of that infrastructure and the return on capital that should be allowed. The objective is to develop an independent assessment of the costs which ought to be efficiently incurred because of the TSO obligations, after allowing for all the compensating benefits.

The TSO cost will be apportioned between Telecom and other liable parties. The liable parties are firms whose networks are interconnected with the Telecom fixed network, and who provide telecommunications services in New Zealand to end-users through their networks. When the Commission has decided on the TSO cost and the amount of the contribution of each liable party, that contribution is payable to Telecom.

The Commission is underway with the first of the TSO cost determinations, covering the period from December 20 last year up to June 30 this year. In the future, each determination will cover a complete Telecom financial year, with liable parties receiving an annual bill for their contribution. Of course, Telecom will continue to meet the bulk of the costs reflecting its market share.

The third function is to propose changes in the services regulated under the Telecommunications Act. The Commission can decide on its own initiative or as a result of a request from the Minister of Communications to investigate whether changes should be made. The process of investigation can include public hearings, which will allow for participation by user interests. While the final decision on whether to make those changes lies with the Minister, and the Government generally, the

Commission makes the recommendation on which the decision is based. In making a recommendation, the Commission will again be following the objectives of the promotion of competition for the long-term benefit of end-users. As an example, if over time a market should become fully competitive, the Commission might recommend that the service be deregulated.

Later this year, the Commission will take up, under this review function, the question of the pros and cons of regulating access to the unbundled elements of Telecom's local loop network and fixed public data network. These are both important arenas for enhanced services such as broadband and the question for the Commission will be whether the market can deliver the benefits of competition, or whether the power to compel access is needed. The Act requires that our report be provided to the Minister of Communications by December next year.

The Commission also has the power to approve telecommunications access codes developed by the Telecommunications Carriers' Forum. Access codes prepared by the Forum relating to functions and standards for regulated services become binding on the industry when approved by the Commission. Though the Forum will largely be dealing with technical aspects of system operations rather than commercial terms for network access, it is an important self-regulatory component of the regime.

Consumer interests are therefore at the heart of the regulatory system, and it is essential that the consumer viewpoint is presented consistently and effectively. In the nature of things, the carriers themselves are deeply involved in the issues the Commission is dealing with. They are directly affected by the decisions the Commission makes, and they have a great deal of information and expert analysis, which the Commission needs.

At the same time, the carriers' interests don't always align with those of consumers. So the Commission has been pleased to see TUANZ taking part in the dialogue on how the regulatory regime should work. We welcome that involvement and look for it to continue.

How are we tackling the agenda of issues we face in telecommunications? In terms of capacity, the Commission has a specialist telecommunications staff team in place. The Government has provided an adequate level of initial funding, and we are leveraging our staff resources through the use of consultants as required. We are in frequent contact with overseas regulators to ensure that we are able to draw on prior work that has been done in other countries. The relevance of regulatory practice in other countries is obvious. It is also entrenched in the regulatory regime by requirements such as benchmarking of interconnection prices against prices in comparable countries, and a requirement that regulated services are to be supplied to a standard that is consistent with international best practice.

The Commission has released a number of position papers on how we see the new regime working. Our aim is to set out our thinking as clearly as possible in advance and to seek feedback before our thinking is set.

We have held several industry conferences, including conferences on benchmarking of access prices and the TSO issue, and more are planned. The conferences have allowed the Commission to explore with the industry and with TUANZ the intricacies of these topics. Extensive submissions and expert evidence have been provided at the conferences, and the Commission has found them to be a valuable process.

Several major access disputes have been filed with the Commission. We are currently investigating a TelstraClear application for a determination of the terms for interconnection of the Telecom and TelstraClear networks. TelstraClear has also asked for a ruling on the terms on which it may wholesale some of Telecom's services. Because these are the first disputes to be dealt with by the Commission under the new regime, they are of considerable importance. They are also complex and contentious. The Commission can fix the prices to be paid by the carriers to one another, as well as other major non-price terms. One of the more significant items will be the length of time for which the

determination is to be in force, before the parties are required to renegotiate. The Commission's determination will be binding on the parties, with only limited rights of appeal to the courts.

Next, as I have mentioned, we are discussing with Telecom and the industry how the net cost to Telecom of the TSO should be determined and what the cost sharing arrangements should be.

And we are thinking about a number of other important issues yet to come, such as number portability, carrier pre-selection for fixed to mobile services, and national roaming for mobile operators.

Clearly, these are still early days and the regime is a "work in progress". Its success will depend on the support of industry, public confidence in the outcomes, and the ability to make quality decisions following a transparent process. There are no easy answers and the challenge for the Commission going forward will be to achieve what has been described as "finding the best possible mix of inevitably imperfect regulation and inevitably imperfect competition".