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LIGHT-HANDED REGULATION OF TELECOMMUNICATIONS IN NEW ZEALAND: IS GENERIC COMPETITION LAW SUFFICIENT ?

by

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A. Introduction

New Zealand's approach to the regulation of telecommunications differs from most other nations and is colloquially known as "light-handed" regulation. New Zealand's approach has attracted considerable international attention in recent years and has been described as "unique", "bold" and even "radical by world standards".

This paper outlines the key elements of New Zealand's light-handed regulatory framework for telecommunications and then critiques this framework in the context of telecommunications interconnection.

This paper suggests that the effectiveness of light-handed regulation is critically reliant upon the effectiveness of the underlying competition law. However, there are serious concerns regarding the ability of New Zealand's generic competition law to adequately address telecommunications-specific issues.

This paper concludes by noting that the New Zealand Government should consider enacting an essential facilities regime or minimalist industry-specific legislation for telecommunications as it is now doing for New Zealand's electricity sector.

While the issues raised by this paper are to some extent a function of New Zealand's market structure, New Zealand's regulatory experience does provide insights for other nations. These insights will be particularly useful for nations that must regulate a dominant telecommunications service provider that controls essential network infrastructure.

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B. Light-handed regulation of telecommunications

I. New Zealand's regulatory philosophy

Over the past decade, New Zealand's telecommunications sector has experienced some of the most rapid and comprehensive reforms in the world. New Zealand has been at the forefront of the global trend towards telecommunications liberalisation and proceeded directly from heavy regulation to unrestricted competition at lightning speed by world standards.

The overall thrust of New Zealand Government policy, in common with that of other OECD economies, has been to deregulate New Zealand's telecommunications sector.

In the case of most OECD economies, this has involved:

- promoting competition where markets are contestable by sweeping away regulatory impediments (i.e., comprehensive deregulation); and
- directing remaining regulation at markets where competition is likely to be obstructed, particularly where a firm has an unacceptably high degree of market power (i.e., industry-specific minimalist regulation).

However, in achieving a balance between these complementary strategies of deregulation and minimalist regulation, New Zealand has heavily favoured deregulation and has been averse to industry-specific regulation. Unlike most countries, New Zealand did not create a specialised regulatory authority to oversee telecommunications competition. Further, and unlike Australia, New Zealand did not enact comprehensive industry-specific legislation to regulate certain aspects of competition within New Zealand's telecommunications markets. Australia, by contrast for example, directly regulated interconnection, equal access and unbundling.

Instead, the New Zealand Government purposely kept any regulation of the telecommunications sector to a bare minimum. In doing so, the New Zealand Government sought to rely on private negotiations between competitors and the dominant incumbent to secure interconnection agreements.

II. The key elements of light-handed regulation

The key legislative elements of light-handed regulation, as currently applied to telecommunications in New Zealand, are:

- the Commerce Act 1986 (the "**Commerce Act**"), which is New Zealand's generic competition legislation. The Government has stated that it places primary reliance on the operations of the Commerce Act to maintain the conditions of effective competition. The Commerce Act prevents anti-competitive conduct in all industries in New Zealand and mirrors the competition and anti-trust legislation of most other western nations. The Commerce

Act is administered and enforced by New Zealand's independent Commerce Commission (the "**Commerce Commission**"); and

- the Telecommunications (Disclosure) Regulations 1990 (the "**Disclosure Regulations**"), which impose certain information disclosure obligations on New Zealand's dominant telecommunications provider, Telecom. These obligations recognise that, at present, Telecom does not face effective competition in the provision of certain telecommunications services and that regulatory transparency is required in relation to Telecom's financial, accounting, pricing and contracting operations to facilitate negotiations with Telecom and to facilitate recourse to the provisions of the Commerce Act.

In addition, there are two non-legislative elements that form an integral part of New Zealand's light-handed regulatory framework for telecommunications:

- the "Kiwi Share" obligation (the "**Kiwi Share**"), which is a special "golden" share in Telecom held by the New Zealand Government. The Kiwi Share imposes on Telecom certain social obligations in relation to domestic telephone services. The Kiwi Share was imposed partially due to the New Zealand Government's failure, for political reasons, to separate the natural monopoly elements of Telecom's operations from its more contestable elements when Telecom was privatised; and
- if light-handed regulation is perceived as unsuccessful, the New Zealand Government has stated that it may introduce heavier regulation. For example, as a result of difficulties that Telecom and CLEAR Communications Limited ("**CLEAR**") faced in reaching agreement on local interconnection, the New Zealand Government threatened detailed intervention if the parties did not resolve their dispute. This "threat" of heavier regulation, such as the imposition of price control, is regarded as a further element of New Zealand's light-handed regulation.

In essence, therefore, New Zealand remains heavily reliant on generic competition law to regulate the telecommunications sector. This contrasts with most other nations, which have favoured industry-specific regulation.

C. Is generic competition law sufficient?

As New Zealand's light-handed regulatory model is heavily reliant on generic competition law, this means that the *effectiveness* of this regulatory model is, in turn, critically dependent on the *effectiveness* of the underlying generic competition law. Accordingly, if the generic competition law is in some way incomplete, incapable or ineffective, then this will create regulatory weaknesses that firms may be able to exploit.

In recent years, the effectiveness of New Zealand's generic competition law has indeed been questioned by firms within the telecommunications sector. It appears that generic competition law, at least in its present form in New Zealand, does have inherent weaknesses

that may be exploited by dominant firms operating in the telecommunications markets. In particular:

- the competition law regime in New Zealand is uncertain, with corresponding incentives for a dominant incumbent to exploit that uncertainty. Breaches of the Commerce Act are difficult to establish and outcomes are capricious and highly fact-specific;
- competition law litigation through the courts in New Zealand is slow and expensive and may itself act as a barrier to entry that may be exploited by a dominant incumbent;
- New Zealand competition law appears incapable of effectively handling the complexity of telecommunications access and interconnection disputes and there remains a real prospect of iterative disputes about different aspects of the same subject matter and even about the same subject matter; and
- the ability of New Zealand competition law to constrain alleged anti-competitive conduct by firms with substantial market power has been weakened by narrow judicial statutory interpretation. This, in turn, has undermined the light-handed regulatory framework.

The principal mischief that New Zealand's competition law should address in telecommunications is the potential for a dominant firm to restrict access to a facility, or service, to which access is essential if a competitor wishes to enter the relevant market and compete. This competitor access issue is commonly known in United

States antitrust law the "essential facilities" issue and is regulated under the Sherman Act.

For example, in the context of telecommunications in New Zealand, allegations have frequently been made that Telecom may extract unreasonable rents from competitors wishing to interconnect into the Telecom-owned public switched telephone network ("**PSTN**"). Interconnection with the PSTN is considered essential for the provision of comprehensive national telephony services by competitors of Telecom in New Zealand.

I. Weakness due to uncertainty

The competition law regime in New Zealand is uncertain with corresponding incentives for a dominant incumbent to exploit that uncertainty. This uncertainty has three main sources.

First is the highly fact-specific nature of New Zealand's generic competition law. Decisions are usually confined to a particular factual pattern existing at a particular point in time in relation to particular players, products and actions. It is often difficult to sensibly apply previous decisions to subsequent different factual patterns. Essentially the matrix of the factual and legal determinants of a decision is too great to allow certainty in relation to

the *stare decisis* rule. This means that litigation inevitably involves a very high element of uncertainty. This also makes it difficult for firms to identify, with certainty, actions that may or may not breach the law.

Secondly, New Zealand's competition law is indeterminate in that it decides whether a particular result is illegal but does not seek to describe and define, or provide a way of describing and defining, what is legal. An entrant is therefore left in an unenviable situation. If the entrant succeeds in proving that a particular access policy and methodology regime chosen by the dominant incumbent is illegal, the dominant incumbent will have the opportunity of designing and choosing another regime for analysis and negotiation. This will result in further cost and further delay. It will not necessarily result in access upon terms and conditions being agreed.

Thirdly, market definition is itself inherently imprecise and thus uncertain. However, market definition is usually the fundamental basis for a competition analysis. Parties involved in Commerce Act litigation will invariably adopt conflicting market definitions that advantage their case. It will often be difficult for a judge to decide which of these market definitions is most appropriate. It is likely that such issues are often resolved arbitrarily. This is not conducive to certainty in the law.

Further, even if a particular market definition is currently justifiable, technology or regulatory reform may easily cause these definitions to be outmoded. In the telecommunications industry, market definition is particularly difficult because of the myriad of products, the amorphous nature of the industry and the rapid evolution of products and services.

By illustration, "market convergence" (or the increasing integration of telecommunications, broadcasting, computing, media and information technologies), is likely to have profound implications for market definition. In the telecommunications industry, the markets as traditionally defined are currently being challenged by rapidly evolving technology.[1] Personal communications services ("**PCS**") for example will increase product substitutability between cellular and wireline telephony leading to their convergence and potential integration. Rapid technological change and market convergence renders it difficult for current players in the New Zealand telecommunications market to achieve certainty when assessing their conduct relative to competition law.

II. Litigation may itself create a barrier to entry

The Commerce Act has been the subject of costly and lengthy litigation in New Zealand. This is particularly the case where the competition issues are complex, as is usually the case in telecommunications, and where large firms are involved that can divert sizeable resources to developing their legal arguments.

1 The Commerce Commission is currently monitoring the effects of this emerging technology on market definition, and more particularly, the effects of the development of broader product markets on current levels of market power.

In the *Telecom* v *CLEAR* litigation, for example, millions of dollars were spent in litigation over telecommunications competition issues with a result that was extremely unsatisfactory from a policy viewpoint and that may ultimately require Government attention. At present, extensive litigation is continuing in New Zealand and there are currently seven competition disputes in the telecommunications industry at varying stages of proceedings in the New Zealand legal system.

The length of time taken in processing Commerce Act litigation is also unsatisfactory. The *Telecom* v *Commerce Commission* litigation over the AMPS-A cellular frequency lasted for 18 months from 30 November 1990 until 23 June 1992 with hearings in both the High Court and Court of Appeal. The *Telecom* v *CLEAR* litigation over interconnection lasted three years from 8 August 1991 until 19 October 1994 with hearings in the High Court, the Court of Appeal and the Privy Council.

In relation to network access issues, there is every incentive for dominant incumbent firms to resort to litigation and thereby delay entry of competitors. By delaying entry for two or three years via litigation, the dominant incumbent may continue to earn excess profits while ensuring that the costs of entry of the entrant are increased substantially by the associated litigation. The dominant incumbent will also be well aware that even if the entrant "wins" the litigation, this will not necessarily resolve the problems. Ironically, Commerce Act litigation itself may impose a substantial barrier to entry and Telecom, as the dominant incumbent, appears to have been quick to realise its tactical value.

III. Complexity of telecommunications access disputes

Another issue that arises is whether New Zealand's generic competition law is sufficiently sophisticated to cope with the complexity of telecommunications competition issues and the ability of astute telecommunications companies to exploit uncertainty and weaknesses in the generic competition law.

By illustration, telecommunications access disputes have tended to have a dynamic and amorphous quality that has permitted them to recur across a wide range of issues at multiple dimensions and in relation to multiple products and services. Access disputes may have, for example, pricing,[2] temporal, functional and technical dimensions and may simultaneously relate to several differentiated, yet continually evolving, telecommunications products or services.

It is clear that problems of access by entrants to a dominant incumbent's network are endemic. The advantages of a dominant incumbent restricting access are so great that access disputes will continually recur across a wide range of issues at multiple dimensions and in relation to multiple services. As innovations occur in the telecommunications sector that

2 The access price may be creatively structured in a way that disadvantages the entrant, confines the margin within which competition occurs, creates perverse incentives, or that otherwise restricts the options of the entrant.

require amendments to access agreements, those innovations will, in turn, become the subject of access disputes if they are not sufficiently provided for in the initial access agreements.

There also remains a continual risk of iterative disputes and iterative litigation about different aspects of the same subject matter and even about the same subject matter. Telecommunications disputes in New Zealand, for example, have covered such issues as access, numbering plans, technological standards, system architecture, new services and availability of information. Much of this litigation is still continuing.

IV. Regulation of firms with substantial market power

Section 36 of the Commerce Act has proved one of the most important provisions for the effective regulation of competition in the telecommunications sector. Section 36 has usually been alleged to apply to Telecom, as the dominant telecommunications provider in New Zealand, and prohibits a person in a dominant position in a market from using that position for the purpose of restricting competitor entry, preventing or deterring competitors or eliminating competitors.

Section 36 is New Zealand's only provision directed specifically at regulating the conduct of dominant firms. Issues involving access to essential facilities, such as equal access and interconnection issues, must, for example, be argued under this section.

However, in recent litigation, the Privy Council (which is New Zealand's highest court) has reduced the effectiveness of section 36 by the application of its test of "use" of dominance as applied in that section. In considering the Baumol-Willig rule (discussed below), the Privy Council concluded that Telecom, in charging CLEAR its opportunity cost for local interconnection, was not using its dominant position since that is what it would have charged in a fully competitive market. The difficulty with the Privy Council's reasoning is that it is the level of pricing that would prevail in a competitive market that is relevant, rather than the fact that firms, whether in a dominant position or not, commonly resort to opportunity cost pricing.

Although there has been good deal of criticism of the Privy Council's reasoning, this narrow approach still remains the law in New Zealand and it is unlikely that this test will change in the near future without legislative intervention.

Unfortunately, as New Zealand's light-handed regulatory framework is critically dependent on the effectiveness of section 36 to regulate the conduct of dominant firms, the weakening of section 36 implies a weakening of the light-handed regulatory framework itself. This is a serious issue for competitors of Telecom in New Zealand's telecommunications sector.

D. Case study : telecommunications interconnection

I. Regulatory background

Interconnection remains the critical issue in the development of competition in telecommunications in New Zealand and is useful to consider the weaknesses of generic competition law within this context. As there is no specific telecommunications legislation ensuring interconnection, the New Zealand Government instead seeks to rely on fair interconnection agreements negotiated between firms seeking to supply telecommunications services. As referred to above, the regulatory framework, under which each firm develops its policies and practices and conducts interconnection arrangements, principally comprises section 36 of the Commerce Act.

Competition in New Zealand telecommunications is contingent upon partial duplication of, and interconnection with, the PSTN. The PSTN arguably comprises a natural monopoly owned by Telecom, with Telecom widely regarded as the dominant telecommunications provider in New Zealand and likely to remain so for many years. Competition in the telecommunications sector is therefore affected, to a considerable degree, by the interconnection policies and practices of Telecom. Telecom undertook in writing to the New Zealand Government that it would provide interconnection on fair and reasonable terms. These undertakings remain in place and are currently the subject of litigation.

When negotiating interconnection agreements, the New Zealand Government expects parties to act in good faith, expedite any court actions and to recognise the unique "light-handed" regulatory nature of New Zealand's telecommunication markets. The New Zealand Government has stated that, if it becomes apparent that the conditions for competitive entry are unnecessarily impeded, then it will consider introducing regulatory measures (for example, in the form of price controls). This was indeed the case with interconnection negotiations between Telecom and CLEAR, with the New Zealand Government threatening to intervene if matters were not resolved within a specified timetable. This threat is regarded as having provided the incentive for Telecom and CLEAR to conclude those negotiations.

Interconnection agreements entered into by Telecom are also required to be published under the terms of the Disclosure Regulations.[3] This provides new entrants, and existing competitors renegotiating their interconnection agreements, with an appreciation of the terms and conditions for interconnection available to other competitors. To some extent, the Disclosure Regulations are intended to remedy the situation of information asymmetries that favour Telecom as the incumbent.

3 Regulation 4(1)(d), Telecommunications (Disclosure) Regulations 1990.

II. Interconnection litigation

Perhaps as a not-surprising consequence of New Zealand's reliance on generic competition law to govern interconnection issues, extensive litigation has accompanied interconnection in the telecommunications sector. Telecom's interconnection policy and conduct in interconnection negotiations have been repeatedly challenged in high profile and extensive litigation, including litigation on the following issues:

- terms for interconnection for competing local network services;[4]
- Telecom's conduct over a requirement that customers of competitors' toll services must dial an access code;[5]
- Telecom's terms for the provision of additional points of interconnection;[6]
- Telecom's terms for interconnection with respect to 0800 toll-free services to be provided by CLEAR to its customers;[7] and
- Telecom's conduct with respect to modification of Telecom managed or leased PABX equipment from customers for CLEAR's toll services.[8]

Of these proceedings, the local service case and the non-code access case proceeded to full hearing and resulted in decisions under section 36 of the Commerce Act against Telecom.

A particularly controversial issue arising from this litigation is a principle for interconnection pricing by the owner of a natural monopoly network facility, such as Telecom's pricing of interconnection to the PSTN. Such issues of interconnection pricing must be negotiated between individual parties and are therefore prone to disputes, as was the situation between Telecom and CLEAR. At Privy Council level (referred to above), it was held that the use of the "Baumol-Willig" pricing rule by Telecom was not anti-competitive under the Commerce Act.

Essentially, the Baumol-Willig rule states that a firm seeking access should pay the incumbent a sum sufficient to compensate it for the opportunity cost of customers lost by the incumbent to the entrant, including the incumbent's forgone profits, if any. Hence, the

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4 CLEAR Communications Limited v Telecom Corporation of NZ Limited (1992) 5 TCLR 166 (HC); 413, (CA); (1994) 6 TCLR 138 (PC).

5 CLEAR Communications Limited v Telecom Corporation of NZ Limited and others, Interim Award of Arbitrator, 26 May 1994.

6 CLEAR Communications Limited v Telecom Corporation of NZ Limited, CP 25/94, High Court, Wellington Registry (proceedings suspended by agreement).

7 CLEAR Communications Limited v Telecom Corporation of NZ Limited (1992), CP 373/92, High Court, Wellington Registry (proceedings suspended by agreement).

8 Proceedings withdrawn by agreement.

Baumol-Willig access price may include the monopoly profits that the incumbent loses by selling access in place of retail line services.

As a consequence of this Privy Council decision, the New Zealand Government instructed officials to examine the public policy implications of the Baumol-Willig rule for interconnection in telecommunications. The New Zealand Government subsequently issued an express disavowal of the Baumol-Willig rule. This has complicated issues arising in respect of network access in New Zealand. The Baumol-Willig rule still remains legal in New Zealand even if it no longer represents current Government policy. This creates considerable uncertainty when negotiating access to systems and provides additional bargaining power to the dominant incumbent (i.e., enabling Telecom to justify charging Baumol-Willig rates, even if these rates are called by another name).

Significantly, it has been said that the final terms of interconnection agreed 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, some industry participants argue that it is unlikely that Telecom will be able to insist on higher access charges for new entrants.

III. Time required for interconnection

As there is no industry-specific legislation regulating the interconnection process, and the terms are left to the parties to negotiate, the time required to make interconnection arrangements may vary considerably. The time required for interconnection depends on the parties involved, the type of services required and, in particular, the ability of the parties to agree on a pricing structure. There are also perverse incentives for Telecom to prolong interconnection negotiations, within the bounds permitted by section 36 of the Commerce Act.

To date, the time required for interconnection with Telecom has been anywhere between two months for toll bypass and international services (Telstra interconnection) and four years for local network services (CLEAR interconnection).

IV. Number allocation, number ownership and number portability

There are no direct statutory controls over numbering in New Zealand. Historically, Telecom has determined numbering issues in New Zealand in accordance with its statutory monopoly. While there existed no competition in the New Zealand telecommunications sector, there seemed to be little difficulty in this conflict of interest between Telecom being the number administrator and also being a service provider. Since the emergence of competition, industry participants have expressed considerable concern that Telecom may be able to manipulate this conflict of interest for its own gain.

Telecom continues to contest ownership of the New Zealand numbering plan on the basis that it was passed to it under the agreement with the New Zealand Government in 1987 by which assets were sold to Telecom as part of its privatisation. Debate within the industry

has tended to focus more on the management and control of the numbering plan by Telecom. While unclear property rights are impeding competition, the New Zealand Government has not yet intervened to resolve the issue. Telecom still seeks to manage the numbering plan through bilateral interconnection agreements with other carriers. To date, Telecom has resisted submissions by other carriers to transfer administration of the numbering plan to an independent body.

Following the entry of CLEAR into the telecommunications market in 1991, the New Zealand Government commissioned two reports on numbering which led to the establishment of the New Zealand Telecommunications Numbering Advisory Group ("**NZTNAG**"). NZTNAG is chaired by the Ministry of Commerce and has an agreed set of rules, but no formal registered charter. All significant carriers are entitled to participate, and representatives are also present from the New Zealand Consumers' Institute and the Telecommunications Users Association of New Zealand (although in recent times, BellSouth and the New Zealand Consumers' Institute have withdrawn from NZTNAG).

NZTNAG has the power to discuss numbering issues and to advise the Minister of Communications on those discussions. As such, NZTNAG has only persuasive, rather than mandatory, powers. NZTNAG operates by way of consensus and therefore provides Telecom with an effective veto. This has inhibited progress on controversial issues, such as New Zealand's *555 Traffic Safety Service and the portability of the 0800 free-phone number.

Number portability allows customers to switch carriers without having to alter their telephone numbers, thus giving customers an enhanced choice of carrier for services. New entrants to the market want customers to be able to port their numbers to the new entrant. The implementation of number portability is accordingly seen by entrants as central to the development of effective competition. All parties to NZTNAG, including Telecom, have expressed acceptance of number portability as a general principle which will benefit competition and the consumer.

However, there have been delays, frustrations and complaints about non-resolution of number portability issues in New Zealand. For example, while there is some general agreement about introducing 0800 free-phone service number portability in the New Zealand market, there are differences in views on the implementation of this, given the competing interests of the network operators. At present, different technologies and methods may be used to implement number portability and agreement on implementation must be reached by commercial negotiation by the parties.

The Commerce Commission has expressed the view that unwarranted delays in introducing number portability are effectively hampering competition developing in the telecommunications sector, and that these delays have the potential to breach section 36 of the Commerce Act. The members of NZTNAG have agreed that call forwarding will provide an acceptable interim technical solution for number portability and that commercial and other technical terms relating to number portability are to be the subject bilateral arrangements between network operators.

V. Access and bundling issues

Other than Telecom's express undertaking to provide interconnection on fair and reasonable terms and the provisions of the Commerce Act (both discussed above), there is no express requirement on Telecom to provide access. However, it is likely that any refusal to provide access would give rise to a strong claim for breach of section 36 of the Commerce Act based on an "essential facilities" type argument.

There is no statute, law or regulation expressly requiring a network operator to unbundle competitive and non-competitive services. However, if bundling is anti-competitive (for example, as cross-subsidisation arguably may be in certain circumstances), section 36 of the Commerce Act will be breached.

The Commerce Commission has expressed the view that, in cases where a monopolist discounts without pricing below cost and without predatory intention, then the effect of the discount is likely to promote 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 section 36 of the Commerce Act. Both BellSouth and CLEAR have commenced litigation against Telecom with respect to bundling by Telecom of competitive and non-competitive telecommunications services, arguing that in doing so there has been a breach of section 36.

E. Policy initiatives and options

I. The industry inquiry report

In November 1991, the Commerce Commission began an inquiry into the telecommunications sector prompted by concerns that effective competition had not developed as quickly as anticipated. This concern was bolstered by a number of complaints relating to the telecommunications industry, and particularly Telecom, relative to other industries. The terms of reference of the inquiry included:

- identifying New Zealand's telecommunications markets ;
- analysing any impediments that were delaying or preventing competitive entry into any of these markets; and
- examining the utility of the Disclosure Regulations and the Commerce Act in removing these impediments.

The Commerce Commission's report identified several impediments to telecommunications industry competition, including the requirement of prompt interconnection to Telecom's network on commercially realistic terms. Telecom's effective control over certain aspects of the telecommunications industry attracted Commerce Commission criticism.

After assessing the application of the Commerce Act and the Disclosure Regulations to these issues, the Commerce Commission concluded, among other things, that:[9]

- the Disclosure Regulations were of "virtually no assistance" in removing impediments to the development of competition in telecommunications; and
- the Commerce Act may be of some assistance, but such assistance is "of a protracted, expensive and uncertain kind, and without definite limitations on its scope".

This report represented, essentially, criticism of the New Zealand Government's light-handed regulatory policy in telecommunications. The reaction of the New Zealand Government was swift, with the Minister of Communications denouncing the report as "superficial".[10] Telecom also brought successful proceedings challenging the Commerce Commission's authority to conduct this inquiry.

II. Recent policy initiatives

As this paper indicates, New Zealand's light-handed approach has not been without its difficulties and criticisms and these have been recognised and reviewed by the New Zealand Government.

In particular, the efficacy of the "light-handed" regime was reviewed extensively by New Zealand's Ministry of Commerce and The Treasury in 1995. Canvassed options for change included:

- enacting an industry-specific compulsory disputes resolution regime, guided by broad principles, for the telecommunications industry;
- appropriate pricing rules for interconnection;
- appropriate mechanisms for allocating any costs of the Kiwi Share; and
- enacting a more rigorous information disclosure regime for Telecom.

In June 1996, after a lengthy period of consultation and review, the New Zealand Government concluded that it intended to continue with the "light-handed" regime in its current form in the telecommunications sector.

III. Current policy initiatives

The result of the November 1996 general election was that New Zealand's National Party returned to power in coalition with the New Zealand First Party. The Coalition Agreement entered into between the National Party and the New Zealand First Party states that the New Zealand Government's preference is for the Commerce Commission and the

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9 Paras 437-439.

10 "Minister hammers report on telecommunications", Otago Daily Times, 7 July 1992, p7.

Ministry of Commerce to address competition issues in telecommunications. However, if this does not produce effective competition, the Coalition Agreement states that the Government is prepared to ensure that effective competition is achieved by producing Government policy guidelines on matters such as interconnection, transparency and number-portability and, if necessary, by amending the Telecommunications Act. The legislative implications of this telecommunications policy are described in the Coalition Agreement as "indeterminate, but could be significant".

In post-election briefing papers, the Ministry of Commerce has highlighted concerns over the level of New Zealand's telecommunications charges and Telecom's high profitability. The Ministry of Commerce noted that it is considering potential improvements to the existing regulatory regime, including:

- the development of arbitration and other disputes resolution procedures;
- the development of rules or principles to govern interconnection; and
- improving the enforcement of the Commerce Act, such as providing for treble damages when the Commerce Act has been breached.

A discussion paper was released by the Ministry of Commerce in January 1998 relating to the strengthening of the enforcement of the Commerce Act. Whether or not the other improvements will be advanced remains to be seen.

It is worthwhile quickly sketching different policy instruments that the New Zealand Government could adopt to resolve the issues raised in this paper and to strengthen the light-handed regulatory regime.

IV. Option I - Essential facilities regime

As noted previously, the "essential facilities doctrine" refers to a body of case law that was originally developed within the United States anti-trust jurisdiction.[11] The doctrine is justified on the basis that if a person controls a facility which is considered essential to a competitor's ability to compete, that person is guilty of "monopolisation" if that person then refuses to allow access for the competitor on reasonable terms. The PSTN, for example, is likely to be considered an "essential facility".

In Australia, the essential facilities doctrine has now been adopted in the form of Part IIIA of the Trade Practices Act which came into force in 1996. This legislation was based on the recommendations of the 1994 Hilmer Committee Report into Australian national competition policy.[12] The amendments have codified a limited form of the essential facilities doctrine into Australian law which governs situations:

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11 See United States v Terminal Railroad 224 U.S. 383 (1912).

12 See Report of the Independent Committee of Inquiry into Competition Policy in Australia, 22 August 1993.

- where the owner of an essential facility and an applicant for access cannot agree; and
- where the essential facility is of national significance; and
- where there is not an effective access regime already in place.

Under the Australian approach, the relevant Minister may declare a certain facility to be an essential facility in certain circumstances and on the recommendation of the Australian National Competition Council. Once a facility is declared to be an "essential facility" the parties remain free to negotiate commercial terms and conditions of access, but if the parties cannot reach agreement then an arbitration process applies.

Once a service is declared, the respective parties are free to negotiate terms and conditions of access. If the parties cannot agree to these terms and conditions they may decide to refer the dispute to private arbitration. If the parties reach agreement through arbitration or negotiation they may apply to have the agreement registered with the Australian Competition and Consumer Commission ("**ACCC**"). Once registered, the agreement may be enforced as if it were an ACCC arbitration determination under Part IIIA.

If the provider of the service and the parties seeking access cannot agree on any aspect of access to a declared service, either the provider or the parties seeking access may notify the ACCC of any dispute and the ACCC can make a determination setting the terms and conditions of access. Such determination may be reviewed by the Australian Competition Tribunal upon application by a party to the determination. A party to the determination may seek to enforce the determination through the Australian Federal Court.

Many years prior to these Australian amendments, in December 1989, the Ministry of Commerce released a discussion paper on essential facilities which discussed the desirability of possible improvements to the Commerce Act based on the essential facilities doctrine. Similar issues have been revisited subsequently, particularly in the August 1995 discussion paper on the regulation of access to vertically-integrated natural monopolies. The outcome of this 1995 discussion paper was that the New Zealand Government decided to continue the status quo.

V. Option II - Telecommunications-specific access regime

From July 1997, Parts XIB and XIC of the Australian Trade Practices Act have created a special access regime for telecommunications in Australia. A similar regime could also be developed for telecommunications in New Zealand.

The Australian regime tightens competition laws in relation to particular circumstances within the telecommunications industry. The provisions also allow guidelines to be issued, and provide for such matters as greater price transparency and mandatory record-keeping. The provisions mandate increased scrutiny by the ACCC in relation to telecommunications.

Part XIC of the Australian Trade Practices Act establishes an access regime whereby network operators are placed under an obligation to promote the long-term interests of end-users in relation to services declared to be important to the development of competition. The regime promotes commercial negotiations but allows supervision by the ACCC where necessary.

The regime is distinct from the essential facilities regime and was developed by the Australians in recognition that the Australian Trade Practices Act was not sophisticated enough to handle access issues as complex as those involved in telecommunications, even with an essential facilities regime. There was a recognition that tougher competition laws were required in relation to telecommunications due to the inherent complexity of telecommunications competition law issues and the scope for exploiting uncertainty in the law.

It is also notable that, in May 1998, the New Zealand Government introduced into the New Zealand Parliament legislation that effectively tightened the application of competition law to New Zealand's electricity sector. This legislation, the Electricity Industry Reform Bill, suggests that the New Zealand Government is now seriously recognising the weaknesses of New Zealand's generic competition law and is willing to move towards an industry-specific model if necessary.

The Electricity Industry Reform Bill, in its present state, is a draconian piece of legislation that mandates a complete separation of natural monopoly businesses from contestable businesses in the electricity industry within five years. The application of competition law to the separated entities is enhanced via rigorous tests and detailed disclosure requirements. In addition, the Electricity Industry Reform Bill introduces the concept of "treble damages" into New Zealand competition law for the first time. The irony is that the electricity industry has experienced considerably fewer competition law problems that the telecommunications industry in New Zealand yet the telecommunications sector has, at present, escaped such an industry - specific approach.

VI. Option III - Credible threat of regulation

As noted previously, the fourth element of the light-handed regulatory framework is the threat of Government regulation. Such a threat is believed to ensure that various players in the industry will continue to negotiate in good faith fearing that otherwise they could be subject to Government intervention. However the current threat of Government intervention is not credible. The manner in which the New Zealand Government is likely to intervene would be to initiate price control pursuant to the Commerce Act. However, this is a dramatic step that would be anathema to Government and that contradicts the Government's current light-handed approach.

The threat could be given greater credibility if a menu of diverse, objective driven measures (capable of both generic and industry-specific regulation) were developed and enacted as law, but left as a "Damocles sword" hanging over industry participants. The manner in which the regulatory framework could be brought into operation could be via regula-

tion at the discretion of the relevant Minister. Provision could be made for Parliamentary oversight of the Minister's decision if that were considered desirable from a policy perspective. It may be useful, for example, to draft and enact the essential facilities amendment to the Commerce Act or a special access regime for telecommunications as referred to above, but to leave the amendment in abeyance to be brought into force at a date to be decided by Order in Council.

F. Conclusions

In conclusion, the effectiveness of New Zealand's light-handed regulation for telecommunications is critically reliant on the effectiveness of the underlying generic competition law, and particularly section 36 of the Commerce Act. Where the generic competition law is in some way incomplete, incapable or ineffective, then this will create regulatory weaknesses in the light-handed regulatory framework that firms may be able to exploit.

In particular, such weaknesses have arisen in New Zealand due to the uncertainty of the competition law regime, the slowness and expense of competition law litigation, the inability of generic competition law to effectively handle complex telecommunications access disputes and narrow judicial statutory interpretation.

The result of these weaknesses for telecommunications interconnection, for example, has resulted in Telecom exploiting its bargaining power to prolong interconnection negotiations and to achieve results that are highly favourable to Telecom but unfair to competitors. Issues such as number allocation, number portability and ownership remain unresolved and, indeed, certain of these issues appear incapable of resolution under the present light-handed regulatory regime without some form of Government intervention.

The light-handed regulatory regime in New Zealand has attracted criticism, including criticism from the Commerce Commission itself. As a result, the New Zealand Government has reviewed the light-handed regime, but has not yet resolved its difficulties. Current policy initiatives by the New Zealand Government may, however, provide some improvement although the extent to which this may be the case remains unclear.

New Zealand could go some way to resolving the current difficulties if it adopted an essential facilities regime or a minimalist industry-specific regulatory regime that complemented and bolstered the existing light-handed regulatory framework.

To some extent, New Zealand's light-handed regulatory approach has provided the world with a unique experiment in the application of light-handed regulatory economic models to the telecommunications industry. The successes, failures and issues arising from New Zealand's regulatory experience provide useful lessons for us all.