

COMPETITION LAW



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Local loop unbundling: a further retreat from light handed regulation

The New Zealand Government's decision last week to unbundle the local loop provides an interesting case study on the evolution of New Zealand's approach to regulatory law.

Once described as "the Australian regulatory system on a starvation diet", the New Zealand regulatory system has undergone significant changes since the enactment of the Commerce Act in 1986.

Local loop unbundling

The wire running from your house or business to Telecom's local exchange is the local loop, or the "last mile".

The local loop is widely regarded as a natural monopoly. While other providers do provide networks, these are limited to areas of concentrated demand in some areas of Auckland, Wellington and Christchurch.

Local loop unbundling means that telecommunications providers will be able to obtain access to Telecom's last mile network at forward-looking cost-based prices, relying on the provisions of the Telecommunications Act.

The decline of light handed regulation in New Zealand

In the past New Zealand has relied on the

Commerce Act to govern competition law and regulation across all industries. The Commerce Act emerged in 1986 as part of the wider market deregulation reforms. It was enacted to replace Government involvement, and to protect the competitive process in order to enhance efficiency and foster economic growth. It applied generically to all industries and was "light handed" in the sense that, in all industries, the market was trusted to deliver optimal outcomes.

The last 10 years has seen a shift away from a reliance on the generic provisions of the Commerce Act. While the generic "light handed" approach has not been abandoned across the board, successive governments have determined that specific industries require specific rules.

The case of telecommunications regulation

New Zealand was one of the first OECD countries to deregulate telecommunications when Telecom was privatised in 1989. For the following 12 years, New Zealand relied on the generic provisions of the Commerce Act to promote competition in the telecommunications market.

The zenith of the "light handed" approach



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was a Privy Council decision enabling Telecom to charge Clear Communications a network interconnection price equal to Telecom's opportunity cost of providing interconnection together with a contribution to Telecom's common costs and profits including any monopoly profit foregone by Telecom from business lost to Clear.

The Telecommunications Act was enacted in 2001 to address specific concerns in the telecommunications market. While it was sector specific, the philosophy of the Act was still "light handed". The Act set up a framework in which network owners and persons seeking access would first negotiate over the terms and conditions of supply and, only if they could not agree, would they refer their dispute to the Telecommunication Commissioner for him to resolve.

When it enacted the Telecommunications Act, the Government did not apply the principles of that Act to Telecom's local loop. It was not convinced at that time that the benefits of local loop unbundling outweighed the potential costs. Instead, the Government instructed the Commission to investigate and recommend to the Minister whether the local loop should be unbundled and whether the Telecommunications Act should apply to access negotiations.

The Commission's local loop investigation

In 2003 the Commerce Commission recommended that the Minister not unbundle the local loop. While the Commission's cost-benefit analysis showed positive benefits to consumers and the New Zealand economy, the Commission noted that the benefits were modest and that there was substantial uncertainty surrounding the effects of unbundling.

Because the Telecommunications Act requires a Commission recommendation before the Minister can recommend regulation, once the Commission

recommended that the local loop not be unbundled, the Minister could not recommend local loop unbundling under the Act.

What has changed since the Commission's decision?

A key catalyst for the change was the MED's June 2005 benchmarking report into New Zealand's comparative telecommunications performance. In that report the MED concluded that while New Zealand's broadband network coverage is good when compared with other OECD countries, broadband uptake is low. One explanation put forward for this low uptake is that free local calling exacerbates the cost differential between narrowband dial-up connections and broadband connections.

Perhaps more importantly, the MED's analysis suggests that New Zealand's business broadband prices are high relative to the OECD. This is despite the Commission having concluded in its local loop unbundling report that Telecom did not face limited competition in: Auckland Central, Mt Wellington, Manukau City, Courtenay Place, and Wellington Central because of the existence of competing networks.

Why unbundle the local loop?

In the last five years there has been a growing amount of economic support for the proposition that information and communications technology (ICT) innovation is a key driver in productivity and economic growth. Telecommunications plays a very significant part in the development and deployment of ICT innovation.

Proponents of local loop unbundling argue that it will promote greater telecommunications competition by allowing access seekers to introduce new and innovative services and drive down costs thus encouraging ICT innovation, deployment and uptake. It will be apparent that the underlying philosophy of these "pro-

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regulators" is that competition (even if enabled by regulation) provides incentives to innovate. However, the Commission's conclusions that Telecom faced competition from competing networks in Central Auckland, Mt Wellington, Manukau City, Courtenay Place, and Wellington Central – areas that would appear to have high business demand – and the MED's conclusion that New Zealand business broadband prices are high, do not sit altogether comfortably with this view.

Those opposing regulation will point to risks associated with regulating an infrastructure business such as Telecom. What incentive will Telecom have to invest if other players can free ride off its investments?

Will local loop unbundling deliver a better outcome for New Zealand?

The MED's benchmarking report illustrates that New Zealand is not performing well compared with its target of being in the top quartile of the OECD.

In the Cabinet paper recommending unbundling Hon David Cunliffe, Minister of Telecommunications reported:

- A common factor in the leading OECD countries is a competitive broadband market.
- Most OECD countries have enacted pro-competition regulatory frameworks and have already unbundled the local loop.
- The OECD identifies local loop unbundling as regulatory best practice.
- Competition in New Zealand's broadband market has not developed to the same extent as in other OECD

countries.

The local loop unbundling decision must also be viewed in the context of the wider implementation review of the Telecommunications Act which is designed to improve the process for resolving access to key services.

As part of this review, Cabinet has accepted a recommendation that the Commission be empowered to instigate a multilateral dispute resolution process under which the Commission would supervise the resolution of key conditions and then, make those conditions simultaneously available to all access seekers. Such a process could be the model adopted for settling the terms of access to the local loop.

Conclusion

The Government's move to unbundle the local loop is a significant regulatory imposition and is a further retreat from the light handed approach previously relied on. This is especially so if the Commission is given a more active role generally under the Telecommunications Act in terms of settling the terms and conditions between providers.

There is no doubt that the costs and benefits of local loop unbundling are not easily quantifiable. Nor is there a guarantee that promoting local loop competition will enhance New Zealand's economic welfare. However, the MED's analysis suggests there is a problem with New Zealand's telecommunications performance and a lack of competition appears to be a distinguishing factor between New Zealand and other OECD economies. Given the apparent relationship between ICT growth and economic welfare, there is ample incentive to try new solutions rather than rigidly apply solutions trialled in the past.