



**Submission in response to  
The Productivity Commission's paper Regulatory  
institutions and practices**

**1 November 2013**  
**Public version** (there is no confidential version)

## Executive Summary

The substance of this submission is that we believe the regulation of the telecommunications sector in New Zealand is a template for the regulatory design of privately owned infrastructure monopolies in New Zealand. Lessons learned in the sector will be useful for regulation in similar infrastructure sectors such as energy and transport. To be absolutely clear – this is not a request to review the Telecommunications Commissioner, the Commerce Commission or specific telecommunications regulations.

The telecommunications sector was the first major infrastructure sector of the New Zealand economy to be privatised. It is arguably also the most complex of the infrastructure sectors. Like other infrastructure sectors it has significant capacity to improve productivity and welfare throughout the economy. Lessons learned about regulatory design in the sector can be translated into other infrastructure sectors and generic regulatory design and practice.

We believe that the Productivity Commission should undertake an independent case study into the regulatory institutions and practices within the telecommunications sector.

We consider that an independent case study would show that:

- the independent regulation of the sector is critically important to productivity within the sector and also the wider economy;
- the design, implementation and incremental refinement of the current regulatory framework has gradually enabled the objectives and purpose set out by Parliament to be met;
- the current regulatory framework is consistent with regulatory frameworks internationally;
- there is little or no evidence of regulatory failure;
- the framework has sufficient feedback loops and safeguards to ensure that it is able to adapt to changing market conditions;
- The Productivity Commission's stated principal purpose: "to provide advice to government on improving productivity in a way that is directed to supporting the overall wellbeing of New Zealanders" will be met by undertaking such a case study.

Separately we believe that the Government should await the outcome of the case study and include the findings in its review of the Telecommunications Act before embarking upon any further reform of the telecommunications sector regulatory environment.

## **Internet NZ**

This submission is from InternetNZ (Internet New Zealand Inc).

InternetNZ is a membership-based not-for-profit organisation and is the delegated manager for the .nz country code top level domain.

Our mission is to protect and promote the Internet for New Zealand. We advocate the on-going development of an open and uncaptureable Internet, available to all New Zealanders. The Society is non-partisan and is an advocate for Internet and related telecommunications public and technical policy issues on behalf of the Internet Community in New Zealand – both users and the Industry as a whole.

This submission is based upon InternetNZ's policy principles, specifically those principles that the Internet should be open and "uncaptureable"; that Internet markets should be competitive and that the Internet should be accessible by and inclusive of everyone.

InternetNZ thanks the Productivity Commission for the opportunity to make this submission.

### **Scope of this Submission**

Due to our limited resources and the limited time we have had available to complete this submission we have concentrated on responding to questions that are most relevant to the regulation and regulatory design of the telecommunications sector. Nevertheless, we consider that there are significant similarities between the sector and other sectors that will prove useful in any generic study of regulation – particularly where the purpose of the regulation is intended to enhance productivity and competition for the benefit of end-users.

Given the shortage of time available to us we would like the opportunity to follow up this submission with further detail and we would be happy to convene a round-table discussion between the organisations that represent Internet end-users and the Productivity Commission.

### **Submission**

#### **What the Commission has been asked to do**

*Q1 What sort of institutional arrangements and regulatory practices should the Commission review.*

The Commission should review the body of regulation and the institutions that are primarily concerned with regulating the commercial behaviour of firms. Particularly where those firms are monopolies or face limited market competition.

*Q2 The Commission has been asked to produce guidelines to assist in the design of regulatory regimes. What type of guidelines would be helpful?*

In sectors, such as infrastructure, where governments have multiple roles (e.g. owners, investors, purchasers, regulators) and multiple objectives (e.g. economic, social, fiscal, commercial, international) two sets of guidelines are required. The first guidelines would cover the institutional forms and functions that would give best effect to clearly separating the different roles of the government. The second guidelines would cover how best to prioritise differing and potentially conflicting government objectives and deal transparently with the trade-offs between different objectives.

The design principles should be such that once roles and objective priorities have been clearly stated by government, the regulatory institutions should then be largely independent to implement the objectives via regulation. What shouldn't be the case is that the regulatory institutions are tasked with attempting to second guess the government's objectives or use regulation to make commercial or other trade-offs.

### **Why this inquiry is important**

While there are no questions posed in this chapter of the discussion document we consider it important to comment that the Commission says its "principal purpose is to provide advice to government on improving productivity in a way that is directed to supporting the overall wellbeing of New Zealanders".

This is an admirable purpose which we support. We add from our experience that competition is a key driver of improving productivity and that often regulation can be withdrawn or reduced if there is a truly competitive market.

We also add that some sectors, in particular the telecommunications sector, not only have the capacity to improve productivity within the sector itself but also have the capacity to improve productivity across all sectors of the economy that use communications technologies such as the Internet. In this respect it is doubly important to ensure that competition and regulation within the sector are as good as they can possibly be and why we consider that the Productivity Commission should consider a case study of the sectors regulatory design and implementation.

We also consider that there have arguably been occurrences of each of the three sub-headings (Regulatory failure; Design failure; and Operational failure) which over time have been addressed.

The Government is currently conducting a review of the Telecommunications Act with the intended outcome that the future regulatory environment will be fit for purpose. In our opinion there is currently little apparent sign of any failure and that feed-back loops and monitoring processes appear to be in place to mitigate any such failures. Consequently we have great concerns that the Government's review does not include any assessment of the status quo and that as a result there is a serious risk of creating future design failure.

We consider the telecommunications regulatory environment would be an ideal subject for a case study by a respected independent body such as the Productivity Commission.

### **The Regulatory Landscape**

*Q3 Does New Zealand have (or need) a unique “regulatory style” as a result of our specific characteristics?*

New Zealand’s has a specific combination of characteristics which is likely to be unique. Nevertheless, individual characteristics are likely to be shared with other countries allowing comparisons to be made. This means that the regulatory style should always recognise international trends and best practice.

We agree with the observations that New Zealand needs an exceptionally good regulatory environment to mitigate the impact of economic geography and that New Zealand is a part of a global regulatory system. Indeed, New Zealand is a party to a number of international treaties that include regulatory provisions.

*Q4 What influences has New Zealand’s specific characteristics had on the way regulation is designed and operated in New Zealand?*

There are several characteristics which appear to have influenced regulatory design over time. The degree of positive or negative influence these characteristics have had in the regulatory design and for that matter the achievement of productivity is not clear and would probably benefit from greater research and study.

Characteristics that would seem to be important include:

History – All infrastructure services were originally built and owned by either central or local government and in that respect were generally national or regional monopolies. Governments regulated these services through ownership and were able to meet their social and economic objectives and make trade-offs relatively easily. As they moved into the private sector (again telecommunications is the obvious example) the commercial objectives of the operators added a different perspective. Some government objectives were built into the sales agreements and in part regulated through contract. Others were regulated via generic Commerce Act legislation. Many of the mistakes made at the time have subsequently been corrected in the telecommunications sector but it would be regrettable if we didn’t learn from those mistakes as the government embarks on fresh sales of infrastructure services.

A small widely distributed market – New Zealand is not unique in this regard, some Scandinavian countries share similar conditions. However different countries have treated differently their favouring of assumed efficiency and the potential social benefits of a single nationwide monopoly service at a nationwide regulated price versus favouring the benefits of competition and lower prices in competitive urban centres at the expense of no

competition and high prices for remote or rural communities. Again, guidance on separating social and economic objectives and upon the respective costs and benefits of different models would be beneficial.

New Zealand is a technology taker not maker - so there is little incentive, as in some countries, to use regulation to protect a domestic industry. Rather, there should be an incentive to open up the domestic services market to competition for the benefit of end-users. Analysis and advice upon whether there are regulatory incentives or deterrents to new entrants entering the New Zealand market would be useful. Anecdotally, most entrants into the New Zealand telecommunications market would say that regulation; particularly Commerce Act competition regulation is heavily weighted towards favouring dominant incumbents.

*Q5 What other ways of categorising New Zealand's regulatory regimes and regulators would be helpful in analysing their similarities and differences? How would these categorisations be helpful?*

As indicated above we consider that critical infrastructure services are substantially different to other commercial businesses and regulation of those infrastructure services requires particular care and attention. They are likely to share a number of similarities which suggests that their regulation and regulatory institutions should also share similarities.

### **Improving regulatory design and operation**

*Q 6 Can you provide examples of regulatory regimes with particularly clear or (conversely) unclear objectives? What have been the consequences of unclear objectives?*

Until recently we considered that the telecommunications regulatory regime had a particularly clear regulatory objective.

The purpose statement of the Telecommunications Act, i.e. the objectives and purpose set out by Parliament, says: the purpose is "to promote competition in telecommunications markets for the long-term benefit of end-users.... by regulating, and providing for the regulation of the supply of certain telecommunications services....".

We also considered that governments over time had successively refined the regulatory environment and it was increasingly meeting this principal objective. At the same time and through separate mechanisms, governments were also achieving other objectives.

More recently it appears that the government has started to confuse its objectives and their implementation and is seeking to meet its investment objectives through a regulatory system directed at promoting competition.

*Q7 Where regulators are allocated multiple objectives, are there clear and transparent frameworks for managing trade-offs? What evidence is there that these frameworks are working well/poorly? and*

*Q8 Can you provide examples of where assigning a regulator multiple functions has improved or undermined the ability of the regulator to achieve the objectives of regulation.*

From the comments made by the Government following the Commerce Commission UCLL and UBA pricing decisions it is reasonably clear that the Government had either not made clear what its regulatory objectives were, or that the Government had provided conflicting objectives without any clear and transparent framework for managing trade-offs. In our opinion it hoped the Commission could fudge the outcome.

The Commerce Commission by law is required to follow the requirements of the Act and did so. The Government after initially saying the Commission's decision was "problematic" has subsequently accepted that the Commission had indeed followed the law. The Government is now reviewing the Act with a view to changing the regulatory settings to promote investment into fibre technology rather than identifying and separating the implementation of its conflicting objectives.

There is ample evidence to show that the framework was working as intended and was meeting the principal objective of promoting competition. There has been little evidence provided that would indicate that it is possible to meet the conflicting objectives (promotion of competition versus guaranteed investment certainty) without cutting across the regulatory principles that are in place – both domestically and internationally.

In regard to the Government having multiple objectives we believe that this is not unusual. Most governments have multiple and sometimes conflicting objectives. That is the nature of government and governments have mechanisms for dealing with them. What is expected of governments with multiple objectives is that it is made clear which objective has priority and how trade-offs are dealt with. Where there are conflicting objectives and those conflicting objectives fall into the purview of an independent regulator, the Government should seek to meet its non-regulatory objectives through non-regulatory means.

In the case of the conflict between promoting competition and providing guaranteed investment certainty, the latter objective can be met in a number of ways that do not interfere with independence of the regulator or transgress regulatory principles. Indeed for a long period we consider the Government recognised the conflict between these two objectives and largely separated their implementation functions - regulation being the responsibility of the independent Commerce Commission and investment certainty being undertaken by Crown Fibre Holdings.

*Q9 Can you provide examples of where a single agency is responsible for both industry promotion and the administration of regulation? What processes are in place to align the*

*incentives of the regulator with the desired regulatory outcomes? What evidence is there of success or failure?*

To some extent the Ministry of Business, Innovation and Employment (MBIE) and Crown Fibre Holdings are responsible for industry promotion and the administration of regulation. In general terms, because their regulatory functions are limited and the major regulatory activities for the sector are undertaken by the Commerce Commission this has not proved problematic – until recently. As discussed above the simple solution to conflicting objectives is the separation of functions.

*Q10 Are there examples of where regulators have clearly defined policy functions? Conversely, are there examples of where the policy functions of a regulator are not well defined? What have been the consequences?*

The Commerce Commission/Telecommunications Commissioner has a small policy and appropriate policy role. It is responsible under the Telecommunications Act for monitoring the performance of the sector. It also, like many regulatory agencies, provides policy advice on how best to implement regulation. In both cases these functions seem to be appropriate and do not step over the boundary into providing advice on government objectives.

*Q 11 Can you provide examples where two or more regulators have been assigned conflicting or overlapping functions? How and how well is this managed?*

Crown Fibre Holdings through contracts it has with Chorus and Local Fibre Companies (LFCs) effectively regulates the price those companies can charge for UFB services. The Commerce Commission through the Telecommunications Act regulates copper based broadband services and is excluded from regulating fibre services until 2019.

We understand why this conflicting situation arose and accept the pragmatic logic that the Commission's objective is to promote competition while CFH's objective is to implement the UFB and these are conflicting objectives best managed by separation.

It is of great concern to end-users and many in the industry that the Government is potentially seeking to amend the Commission's objectives to, in part, support the implementation of the UFB through regulation of copper broadband services, or alternatively remove from the Commission the function of determining the regulated wholesale price of copper broadband services.

*Q13 Can you provide examples of where two seemingly similar regulatory areas are regulated under different regulatory structures? What factors have contributed to differences in the regulatory structures?*

Regulation of broadcasting, radio spectrum interference and allocation and telecommunications are regulated under different structures largely because historically they were different sectors. With the convergence of the underlying digital technology



these sectors are increasingly combining. A number of countries have taken the opportunity to combine previously separate regulatory agencies to keep pace with converging technology.

### **Regulatory independence and institutional form**

*Q14 Are the dimensions of regulator independence discussed in Figure 4.2 helpful in thinking about New Zealand regulators?*

Yes

*Q15 Which of these dimensions of independence is most important to ensure a regulator is seen to be independent?*

We concur with the statement in the document that says “Independence from those who make laws prevents a regulator being used for partisan purposes, promotes public confidence in the decisions of the regulator, and allows it to work constructively with the sector being regulated”.

In this regard all four dimensions of regulator independence are important and it is difficult to isolate one dimension having greater importance.

*Q16 Can you provide examples of where a lack of independence or too much independence according to one of these dimensions undermines the effectiveness of a regulatory regime?*

Under schedule 3 of the Telecommunications Act, the Telecommunications Commissioner has to recommend to the Minister any new regulated service and the Minister/Government has to accept the recommendation for the regulation to be introduced. This lack of independence was initially considered to be a safety net to allay fears about overzealous regulators. There are instances where those proposed to be regulated have used this safety-net to game and significantly delay the regulatory process.

*Q17 What should be the limits of regulator independence? What sorts of regulatory decisions should be the preserve of Ministers rather than officials?*

This is largely dependent upon the degree to which Ministers/Government have conflicting roles and objectives. Where there are clear conflicts between different government objectives, there should be few if any limits on the regulator’s independence as long as the regulator works within the specified requirement to meet the defined regulatory objective.

*Q18 Do you agree with the list of features in Figure 4.3 which indicate a need for more or less regulatory independence? What other criteria are missing?*

We agree with the list of features which indicate a need for more regulatory independence. In regard to the list of features which indicate a need for less independence, these need to be conditioned to take account of government having conflicting objectives and incentives.

*Q19 Is regulatory capture more or less likely in a small country? Can you provide examples of capture in New Zealand?*

Regulatory capture is more likely in a small country particularly where there are large monopoly companies who have significant resources available to devote to lobbying regulators and governments. The larger a country the more likely it is that there is effective competition and that competitors will be able to likewise counter-lobby.

*Q20 Are there other institutional forms for government-established regulators?*

Within the telecommunications sector there is some element of industry self-regulation. This is mostly in the areas of technical codes and service quality standards and is probably a pragmatic approach to issues that should be resolved by the industry. There is a safety-net ability for the Commerce Commission to intervene should that be necessary.

*Q 23 Are there aspects of regulatory independence that are more or less important in regulating state power or government-provided/funded services?*

The report says “there may be challenges in regulating services substantially funded by government....the risk of regulatory capture may be heightened. In particular there is the potential for the tension between the government’s fiscal objectives and its regulatory objectives to be resolved inappropriately where a regulator is insufficiently independent”.

As discussed above we consider that in the telecommunications sector the regulator should have significant independence to regulate the sector and that if the government wishes to pursue other objectives such as the UFB it should do so entirely separately and transparently rather than seeking to bring about a fiscal or commercial objective through regulation designed to promote competition.

### **Decision review and appeal**

*Q 26 How effective and consistent are the review and appeals processes provided for in New Zealand regulatory regimes? and*

*Q 27 Can you provide examples where the review and appeals processes provided for are well-matched or poorly suited to the nature of the regulatory regimes? and*

*Q 28 What are the advantages and disadvantages of a general merits review body like the Australian Administrative Appeals Tribunal?*

Merits review has long been an area of debate within the telecommunications sector and the arguments for and against are well rehearsed. From the perspective of end-users, merits review appears to be an additional expensive and lengthy process that operators use to avoid or delay regulation. In New Zealand it would follow other lengthy regulatory processes that are designed to allow operators every opportunity to make their case.

If, operators seeking merits review paid the full cost (i.e. the costs of all parties) of the review; the original decision being review stood until such time as the merits review was completed; and the merits review body was authorised to adjust the regulatory decision in either direction end-users would be more inclined to accept arguments for merits review.

### **Allocation of risk through the regulatory system**

*Q 29 Can you provide examples of regimes where risks are borne by a regulator, regulated party, or the public/consumers, but they are not best placed to manage those risks?*

Some operators claim that they face investment risks due to regulatory uncertainty – i.e. that potential investors factor into their investment decisions the likelihood of negative regulatory change.

We would say that investors are best placed to manage any risks associated with regulatory uncertainty. Regulatory decisions are well signalled and are based on specified and well understood processes in which the regulated organisations have every opportunity to present their case. Regulated organisations are best placed to model potential regulatory impacts and advise their shareholders accordingly.

### **Funding and Resourcing**

*Q 30 Can you provide examples of where the mix of funding sources contributes to the effectiveness or ineffectiveness of a regulatory regime?*

There is some minor concern that organisations seeking regulatory review have to contribute to the costs of the review – this is meant to be a deterrent to vexatious review requests. There is some evidence that small market entrants are unable to afford the cost of the review and/or they are completely outgunned by big incumbents if they do request a review. This may contribute to some ineffectiveness within the regime. Consideration could be given to the Commission being able to assess the prima facie merits of a review request and if they stack up then waive the contribution.

*Q 31 Is the mix of funding sources for individual regulators consistent with their stated funding principles?*

We believe so.

*Q 32 Which New Zealand regulators (or regulatory regimes) provide good examples of open and transparent funding arrangements? Can you provide examples where the transparency of funding needs to be improved?*

We have no issue with the transparency of the funding arrangements for the Commerce Commission. To the extent that CFH is deemed to be a regulator there may be issues of transparency.

## **Regulator workforce capabilities**

*Q 36 Where are there gaps in regulator workforce capability? Can you provide examples?*

There may be historic examples where the Commerce Commission/Telecommunications Commissioner has had insufficient engineering/technical expertise which has resulted in decisions that reportedly were technically impossible to implement. To the best of our knowledge this insufficiency has been resolved.

*Q 37 What is the potential to improve capability through combining regulators with similar functions, compared with other alternative approaches?*

In general terms we consider that the horizontal combination of regulators – i.e. single regulators covering multiple sectors is preferable to vertical integration of functions within a sector – i.e. policy advice, regulation, enforcement, monitoring.

There is probably some potential for infrastructure regulators to be combined.

## **Compliance monitoring and enforcement**

*Q 39 Can you provide examples of strengths and challenges in a way regulators monitor and enforce regulations? What are the consequences?*

Since the Commission was provided with additional monitoring and enforcement tools in 2006 this appears to be working well.

*Q 40 Do New Zealand regulators have access to a sufficient range of enforcement tools? If not, what evidence is there to suggest a broader range of tools would promote better regulatory outcomes?*

To the best of our knowledge, within the telecommunications sector, the range of enforcement tools available to the regulator is determined within primary legislation and the regulator and affected parties are consulted and are free to make submissions through the legislative process on the range of enforcement tools. This seems to be an effective means of arriving at a sensible outcome.

*Q 41 What sort of regulatory regimes are suited to more (or less) discretionary enforcement? and*

*Q42 Can you provide examples of where a regulator has too much or too little discretion in enforcing regulations? What are the consequences?*

A recent decision by the Commerce Commission to warn SKY rather than prosecute them would seem to be an indication that the Commission is insufficiently empowered or is encumbered by the Commerce Act legislation it works under.

We are unable to comment in detail on this issue but the end result is almost certainly poor for productivity in the broadcasting/Internet/telecommunications sectors. This may also be an area where the Productivity Commission could usefully provide advice to government.

## **Engagement**

*Q45 Can you provide examples of where regulatory regimes require too much or too little consultation or engagement? What are the consequences?*

The consultation processes relating to telecommunications regulation are defined in legislation and are generally in line with international treaty requirements. There are instances where operators game the consultation processes either to their own advantage or to delay implementation - nevertheless, we would consider the consultation processes are sufficient.

*Q46 What are the characteristics that make some regulations more suited to prescriptive consultation requirements than others? and*

*Q47 What forms of engagement are appropriate for different types of regulatory regime? When do formal advisory boards work or not work well?*

There is a lot of prescriptive consultation specified in the Telecommunications Act - clearly where the regulation has significant impact upon the costs and revenues of organisations those organisations should be given sufficient opportunity to respond. In similar vein, while end-users are often consulted by regulatory agencies the requirement is rarely prescriptive and often end-users are significantly under-resourced to respond at the level of detail that those subject to regulation are able to do.

There should be requirements to consult with end-users or their representatives and given their lack of resources consideration should be given to how end-user organisations might be assisted.

## **Accountability and transparency**

*Q55 Can you provide examples of how accountability or transparency arrangements improve or undermine the effectiveness of a regulatory regime? and*

*Q56 What types of accountability or transparency arrangements are appropriate for different types of regulatory regimes?*

We are only able to comment in regard to the Commerce Commission. From an end-user perspective it is essential that there is a maximum amount of transparency and accountability. We do not have the information or the resources to analyse information that large regulated organisations have. It is essential to end-users that the Commission analysis going into regulatory decisions along with the counter analysis provided by the regulated

parties is available for public scrutiny and that cross-submissions are part of the consultation process.

It is also important that “expert witnesses” appearing at Commission conferences are professionally accountable for their submissions.

### **Performance assessment**

*Q57 Are the problems that the Commission identified in the assessment of local government regulatory performance also evident in the assessment of central government regulatory performance? If not, how do the problems differ for central government?*

Not that we are aware of.

### **Foreseeing or learning from regulatory failure**

*Q60 Can you give examples of indicators or proxies that are effective as early warning signs of regulatory noncompliance or failure?*

Lack of sufficient competition and the high prices of telecommunications services in New Zealand can be considered to be indicators of pending regulatory failure.

*Q61 Can you provide examples of regulatory regimes with effective processes for formally or informally raising concerns about potential regulatory failures? What examples are there of regimes that handle this poorly? What are the consequences?*

For a number of years the Commerce Commission and many commentators have raised concerns about the apparent design failure of the Commerce Act competition test. This raises concerns about the ability of the Commission to effectively achieve its regulatory objectives. It would also appear to have resulted in the Commission deciding not to progress anti-competitive cases.