

Submission by the Commerce Commission on the Telecommunications Service Obligations Regulatory Framework Discussion Document (August 2007)

Introduction and Summary

1. The Commerce Commission is responsible for exercising functions and powers under the Telecommunications Act 2001 (the “Act”). One of the purposes of this Act is to promote competition in telecommunications markets for the long-term benefit of end-users by regulating the supply of certain telecommunications services. The Commission is required in exercising its functions and powers to consider the efficiencies which are likely to result from its acts or omissions.
2. The Commission is also the agency that is responsible under Part III of the Act for administering the current regime in relation to the Telecommunications Service Obligation (“TSO”) instruments.
3. The purpose of the TSO is to facilitate the supply of certain telecommunications services to groups of end-users within New Zealand to whom those services may not otherwise be supplied on a commercial basis or at a price that is considered by the Minister to be affordable to those groups of end-users. The Commission recognises the importance of this social policy objective.
4. The Commission considers that the TSO in its current form compromises competition and new investment in the network in rural areas. While the Commission acknowledges that there are social policy objectives that may outweigh these disadvantages, these can be met in a number of ways.
5. The objectives of the Local Service TSO can be met in a less distortionary manner. This means addressing affordability issues only for those in real need, funding this assistance in as neutral a manner as possible, and minimising the administration and compliance costs required to provide the assistance.
6. In order to ensure the affordability of the local telephone service, there is no compelling reason to have a mechanism that is:
 - funded by the telecommunications industry;
 - tied to a particular provider;
 - applied to all residential customers in a particular geographic area rather than targeted to those in need;
 - implemented via a TSO deed and bureaucratic determination process; or
 - treated differently from other social assistance mechanisms.

7. The Commission is happy to contribute to developing options for replacing or reforming the Local Service TSO and the generic TSO framework.
8. If the Government wants to retain the Local Service TSO largely in its current form then it would be best to make it a specified amount TSO and exclude, as much as possible, those customers who should be able to afford to pay market rates for their telecommunications services, such as significant home-based businesses and owners of second residences.
9. If industry funding of the TSO is also to be retained then there may be a simpler method of calculating TSO-qualified revenue that lowers the compliance cost of liable persons while remaining reasonably fair. We are happy to work through the available options with the Ministry.
10. The Commission has not commented on emergency call service issues or the means for maintaining quality standards for end-users of the local telephone service.

Purpose of TSO

11. The Discussion Document indicates that without the TSO, rural consumers may have been vulnerable to Telecom ceasing to provide local service or raising the price dramatically in higher cost areas.
12. The Commission considers that if the Local Service TSO was removed, the consequences for the ongoing supply of the local telephone service are likely to be limited. However, it is probable that users in higher cost areas would face higher line rentals and local calling charges. They may also face higher connection charges, although these are not explicitly governed by the TSO.
13. The Commission therefore considers that the primary outcome of the Local Service TSO is to make a local telephone service more affordable to some rural users than it may otherwise be.
14. The development of fixed wireless and satellite technology means telecommunications services can now be delivered to virtually any geographic location, without the need for a wired network. This would limit the scope for local service charges to rise in rural areas.
15. The Commission acknowledges that services of this kind may be different in quality, or more expensive for consumers in high cost areas compared to local telephone services in lower cost areas. However, the availability of these services will provide competition for the local telephone service at prices that will be affordable for many consumers, even if they are higher than in urban areas.
16. These developments suggest that the social cost of removing the TSO may be smaller than expected when the policy objectives were originally developed.

The TSO Obligations

17. The original Kiwi Share Obligations (KSO) were conditions of Telecom's privatisation.
18. The Local Service KSO was renegotiated in 2001 to clarify its requirements and to introduce minimum service standards (most notably, minimum speed requirements for dial-up internet connection).
19. The service standards governing the TSO are specified as an annual average across the whole country. Telecom has consistently met these standards. It is not clear to the Commission whether Telecom was already meeting these standards in 2001 before the commencement of industry compensation.
20. Nor is it clear whether the introduction of the service standards in 2001 has led to any increased investment in the access network.
21. In the Commission's view, the advantages that may have been expected to accrue from the re-negotiation of the TSO in 2001 have not been realised.

TSO Administration

22. Administering the Local Service TSO and making determinations each year has been a lengthy, complicated and costly process for the Commission. The telecommunications regulatory activities of the Commission are funded by the telecommunications industry.
23. To meet the requirements of the legislation governing the TSO, the Commission has had to model a fixed network to serve all residential customers as at December 2001 and to determine an appropriate return on the capital invested in this network. The modelled access network has been re-optimised each year.
24. To allocate the cost of the TSO among liable persons the Commission has had to implement a practical way of calculating the TSO-qualified revenue of each liable person. The legislation describes this revenue as revenue received by liable persons from providing telecommunications services by means of their PSTN or by means that rely primarily on the existence of their PSTN or any other PSTN. To more tightly define such revenue and head off attempts by liable persons to minimise their TSO-qualified revenue, the Commission has developed 28 rules that liable persons must follow in calculating TSO-qualified revenue.
25. The TSO is likely to have imposed considerable compliance costs on the telecommunications industry given the complexity of the cost modelling and the adversarial nature of the determination process. The calculation of TSO-qualified revenue by liable persons is also not an insignificant exercise.

26. In summary, the TSO determination process required under the current legislation is complex and costly.

Limiting Distortions to Competition

27. The Commission does not consider that the TSO in its current form encourages competition and new investment in the telecommunications network in rural areas.
28. There would be greater industry competition and therefore incentive to invest in rural areas if rural consumers who could afford it were charged the true cost of their telecommunications services. This would give appropriate signals for both the consumers of telecommunications services and suppliers undertaking ongoing investment in telecommunications infrastructure.
29. The Commission recognises that this approach may not deliver on the Government's wider social objectives. However, rather than adding further conditions to an already cumbersome TSO framework, there are other more straightforward and transparent tools that the Government could use to encourage upgrading of the telecommunications network. An example is targeted assistance for capital investment along the lines of Project Probe.
30. Even assuming that the main purpose of the TSO is to ensure affordability of telecommunications services, there is no compelling reason for such a mechanism to be:
- funded by the telecommunications industry;
 - tied to a particular provider;
 - applied to all residential customers in a particular geographic area rather than targeted to those in need;
 - implemented via a TSO deed and bureaucratic determination process; or
 - treated differently from other social assistance mechanisms.
31. Competitive telecommunications markets will be best promoted when the objectives of the TSO are met in the least distortionary manner. This means addressing affordability issues only for those in real need, funding this assistance in as neutral a manner as possible, and minimising the administration and compliance costs required to provide the assistance.
32. Extending the TSO to cover broadband services would increase distortions.

Impact of NGN

33. When NGN technology is introduced in the access network, Telecom has indicated that the current distinction between the delivery of voice and broadband over customer access lines will disappear. It would, therefore, no longer make sense to have separate TSOs for voice and broadband if these were in existence prior to this event.
34. A move away from traditional PSTN interconnection will also remove the basis the Commission currently uses to identify the liable persons amongst whom the TSO cost is apportioned (liable persons are currently those persons directly interconnected with Telecom for the exchange of voice traffic). The current definition of liable person will not work in an NGN world. If such a definition continues to be required it should make the identification of liable persons relatively simple and not rely on the Commission having to independently identify every provider of telecommunications services operating in New Zealand.

TSO Costs

35. If the TSO is to be retained largely in its current form, the adverse effects of the TSO would be lessened by making it exclude, as much as possible, those customers who should be able to afford to pay market rates for their telecommunications services, such as significant home-based businesses and owners of second residences. This should have a two-fold effect of allowing market prices to be set for more rural customers and lowering the cost that needs to be recovered.
36. The administrative and compliance costs of the TSO would be significantly reduced by making it a specified amount TSO, fixed for a number of years. The specified amount would have to be negotiated taking into account any alteration to TSO scope and the other considerations raised in this submission.

TSO Funding Arrangements

37. The Commission considers the most neutral funding arrangement for the TSO would be to fund it from general taxation. However, if the Government considers it necessary that the industry continue to fund the TSO then there may be a simpler method of calculating TSO-qualified revenue that lowers the compliance cost of liable persons while remaining reasonably fair. For example, TSO-qualified revenue could be based on the income tax or GST payable by liable persons for the prior financial year. This may reduce the complexity of the calculation, although the figure may need to be apportioned to take account of earnings not related to telecommunications.

Conclusion

38. The Commission acknowledges that the TSO instrument is designed to achieve important social policy outcomes. Nonetheless, there are alternatives to the current regulatory settings which would have a less distortionary impact on competition and be easier to administer.
39. The Commission is happy to contribute to developing options for replacing or reforming the Local Service TSO and the generic TSO framework.