

ISSUES AND PRIORITIES IN TELECOMMUNICATIONS REFORM IN JAPAN - THE TELECOMMUNICATIONS BUSINESS LAW

EUROPEAN BUSINESS COMMUNITY (EBC) POSITION PAPER

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1. Introduction

This paper identifies the current key issues in Japanese telecommunications competition law reform. The objective is to show where action is necessary in the implementation of the new Telecommunications Business Law (TBL), and the content of its supporting ministerial ordinances, to achieve fair and efficient competition in the Japanese telecommunication services market.

This paper is based on, as yet, an incomplete understanding of the way in which the new TBL will operate. The ministerial ordinances that will support the new TBL are yet to be drafted, and so the European Business Council (EBC) hopes that the comments presented in this paper will assist the government departments in this crucial work.

The general issues for reform of Japanese telecommunication law are identified in section 2 of this paper, and actions necessary to address these issues in the context of the new TBL and associated ministerial ordinances are identified in section 3. Finally, section 4 draws together the EBC's recommendations to the Government of Japan in relation to the new TBL and its supporting ministerial ordinances.

2. Features of the Existing Japanese Telecommunication Services Market

There are three key features of the Japanese telecommunication services market that act as a hindrance to effective competition:

- **Dominance of NTT** – Effective competition requires rigorous Government action to control the former monopoly fixed line operator, both in markets where it has dominance (e.g. local access), and in markets where it can benefit from dominance in related markets (e.g. NTT-Communications can benefit from NTT East and NTT West's local access dominance). NTT's dominance is pervasive throughout all its group companies, and enables it to strangle the development of competition. There are no effective regulatory constraints on NTT, other than where it has clear bottleneck facilities. Even here, however, enforcement of regulatory constraints is not always effective. In all other areas NTT continues to enjoy all the benefits of

dominance flowing from its former monopoly position. Strong sector-specific regulation of the fixed line market targeted at NTT is necessary to encourage the development of competition and prevent NTT abusing its dominance, and assurance that appropriate constraints are being effectively applied.

- **Over-regulation of competitors** – Under the existing Telecommunications Business Law (TBL), Japan is the only country in the world where competitors are subject to many of the same regulatory controls as the incumbent. The obligation to price on tariff is a good example. This means that competitors can only charge prices that are set out in a schedule of charges filed with the regulator. This obligation is not only administratively burdensome but, by restricting the ability to tailor deals for particular customers, “straightjackets” pricing by competitors and unreasonably restrains their ability to attack the incumbent’s customer base and prices. Most overseas regimes only apply this obligation to the incumbent, to stop it from price discriminating in a way that is damaging to competition. Competitors, by their market position, are incapable of this kind of action. In Japan, however, the tariff filing obligation is applied to competitors, and so locks in the incumbent’s dominant customer base, and prevents the development of price competition.

- **Transparency, accountability, and predicability** –These are issues of continuing concern in Japan. The Japanese regulatory process does fully not meet the three key principles of EU directives: openness, fairness and transparency. There are three key problems:
 - *Need to seek administrative consent* – The arbitrary and vague nature of legislation and regulations requires operators to constantly seek guidance from the regulator on the meaning of particular rules in particular situations. This institutionalises the “micro-management” problem, based on the large degree of discretion available to the MPHPT. Regulatory rules need to be clearly stated in advance in the interests of certainty, fairness and predicability. Non-dominant operators, in particular, need to be given the freedom to operate and develop their businesses with a minimum of regulatory supervision or control. The outcomes of the regulatory process need to be economically rigorous.

 - *Inadequacies in the public consultation process* – The Government requires Ministries to publicly consult on changes in policy, but the requirements of this consultation are vague. It seems that most policy decisions are made behind closed doors, with too little information to assist public comment, or taking account of public comment in final decisions. As a result, the consultation process is merely “window dressing”, and has little or no effect on policy decisions. Reflecting the emptiness of the procedure, consultations

are forced through in unreasonably short timeframes, without regard to the problems of translation faced by foreign operators. These problems prevent meaningful participation of foreign operators in the decision-making process.

2. Prioritised Issues for the New Telecommunications Business Law

This section looks at priorities for the ministerial ordinances implementing the structure of the new TBL. The section is arranged around the EBC's principal areas of concern:

- dominant carrier regulation:
 - definition of dominance;
 - regulation of dominance and anti-competitive conduct;
 - “regulation” of non-dominant carriers;
- public consultation processes.

Dominant Carrier Regulation

A key design defect in the current regime is the failure to target regulation sufficiently at the market failure resulting from NTT's overwhelming dominance in the local loop and related downstream markets – enabling NTT to stifle the development of effective competition.

Definition of dominance

The accepted definition of dominance is the ability of a company to act independently of competitors, customers and suppliers. The new TBL must not restrict the dominance of NTT companies to be only where they have bottleneck facilities. This is because possession of bottleneck facilities is not the only source of dominance. Overwhelming market share, and the potential to leverage power between markets through activities such as co-branding and sharing of sales resource are two further sources of dominance. Therefore, markets in which NTT-East and NNT-West provide data services, and also markets where NTT-Communications operate, should also be included as candidates for NTT dominance. Regulation of tariffs and other actions, therefore, must be extended to parts of the wider NTT group, where NTT companies are able to leverage their dominant position gained from local network bottleneck facilities.

An internationally accepted methodology for competition analysis and review (identification of appropriate market boundaries, and the identification of significant market power within those boundaries) – such as OFTEL's Effective Competition Review – to give the regulator the tools it needs for its ongoing competition and monitoring role and produce economically robust competitive outcomes, must be a priority for the new TBL and its ministerial

ordinances. This would follow the European model of assessing Significant Market Power in a range of markets.

Regulation of dominance and anti-competitive conduct

Once dominance has been identified, regulation of dominance in the new TBL and its supporting ministerial ordinances must reflect an international best practice model. The following measures need to be adopted into the Japanese regulatory framework:

- Strong regulatory accounting and information disclosure requirements on the incumbent, and investigative powers on the Soumusho – to enable the anti-competitive conduct to be more readily identifiable and to enable regulatory processes to be based on rigorously gathered and transparently disclosed evidence. This is critical if reliance is to be placed on ex-poste monitoring of dominant carrier behaviour within the TBL. Without suitably strong information disclosure, competitors will be unable to identify dominant carrier malpractice.

European experience shows that it is critical to apply strict obligations for the incumbent, and investigative powers for the regulator, to ensure transparency of costs by service as well as network element, to ensure charges to competitors are cost-based, to monitor and prevent anti-competitive behaviour, and to provide a means of independent audit. The cost and other information derived from this process has a critical bearing on competition. The absence of detailed obligations that comply with international best practice, such as those which are imposed by OFTEL on BT in the UK, is a fundamental weakness of the current regime.

- Stronger “ring fencing” rules to prevent NTT from leveraging its dominance in the local loop into new business areas. The lack of accounting and regulatory information makes such conduct not readily identifiable. Current guidelines on granting approval for NTT-East and NTT-West business expansion lack requirements for transparency, and accountability for the Soumusho to adequately investigate. As a result, NTT is now expanding into new business areas, such as Internet and data services, with no effective constraint on its ability to leverage its dominance and monopolize new markets.

For example, the EBC is concerned that NTT is leveraging sales in non-competitive services through sales co-operation and co-branding to competitive services, and that this behaviour is going unchecked by the regulator. Such predatory behaviour will result in substantial damage to the process of competition, and could force the exit of competitive carriers, to the detriment of consumers and the sector as a whole.

Two specific examples are:

- the NTT-East and NTT-West business expansion into inter-prefecture Internet backbone services;
- the establishment of NTT BB providing broadband services.

Both these developments leverage NTT's dominance in local access services into local and regional broadband data services, through sales co-operation and co-branding. There may also be a case for the MPHPT to use its powers to undertake a thorough investigation of the stand alone profitability of these businesses, taking a critical approach to any costing assumptions made by NTT.

- An effective methodology is required to regulate all dominant carrier tariffs. It is of considerable concern that the new TBL framework will allow NTT-East and NTT-West freedom to move onto unregulated contracts for any customers they chose, irrespective of the NTT-East and NTT-West market position. The use of tools to monitor and prevent anti-competitive pricing by the incumbent in fixed line services, such as OFTEL's "Stack Test", have been discussed. However formal requirements to undertake this kind of analyse do not appear in any legal requirements (as they do, for example, in BT's license), and so it is imperative that they are included in supportive ministerial ordinances to the new TBL.
- Developing a culture of "enforcement" within the regulator – so that the incumbent knows that, if it behaves anti-competitively, it will face the consequences of its actions.

It appears to have relatively little attention to actively monitoring anti-competitive behaviour by the incumbent. Rather than relying on evidence from competitors (which will inevitably be incomplete), it is critical for Soumusho use its powers to obtain data from NTT companies to actively investigate cases of anti-competitive behaviour by all NTT companies, whenever they have market power, or have potential to leverage market power from related markets (such as access). The Soumusho must be required, under the new TBL or its ministerial ordinances, to publish the results its investigations. This approach has been adopted in most other jurisdictions, including major Asian jurisdictions such as Hong Kong and Singapore, and should be adopted in Japan.

Regulation of NCCs

Under the existing TBL, there is substantial and unjustified over-regulation of non-dominant operators under the current Japanese regulatory regime. This impedes the ability of competitors to compete effectively with NTT and deliver lower prices and more innovative services to consumers.

An example of this over-regulation is tariff filing. Non-dominant carriers are required to make extensive filings with Soumusho. These filings include wholesale and retail tariff packages, wholesale and retail prices, network lay-out, technical specifications, contractual terms, and other assorted information.

These filings serve no regulatory or public policy function when applied to non-dominant operators. Non-dominant operators in the Japanese market have no ability to impose unreasonable terms and conditions on their customers or to otherwise harm the process of competition. They have no essential facility or monopoly rights, so if customers are dissatisfied with their service, they are able to migrate to a competing supplier at little or no cost. The filings do not generate any benefits for customers, the industry, or the regulator, but do have significant drawbacks.

In addition to the competitive implications of these tariffs, the administrative drawbacks of the regulatory filings include:

- The direct cost to operators of preparing, submitting and explaining their filings. Given the rapid pace of change in the sector, and the need to frequently refile documents, the cost of meeting this obligation is high. This is a cost which must be passed on to customers.
- The cost to Soumusho of reviewing and maintaining the voluminous filings submitted by operators.
- The diversion of Soumusho's attention (and resources) away from more important regulatory issues, such as monitoring of anti-competitive behaviour, to the detriment of the sector.
- The inertia the filings generate in the industry, as carriers are reluctant to make significant changes to their tariffs and networks, because of the heavy obligation to submit extensive new filings.
- The uncertainty as to exactly what information needs to be filed (and when), which creates an ongoing area of risk for operators.

- The inability of non-dominant operators to respond flexibly to competition, both in terms of pricing and service features, placing non-dominant carriers in a regulatory straight jacket, which is unresponsive to consumer demands.

Most other regulatory regimes do not require non-dominant carriers to file network and tariff information. Some regimes, such as Singapore and Hong Kong, require *dominant* carriers to file such information (given the damage they can cause to the process of competition), but these regimes have recognized the need to give non-dominant carriers the flexibility to change their networks and tariffs.

Soumusho should have the powers to request information from all carriers when carrying out competition investigations, but the ongoing tariff filing obligation on non-dominant operators should be abolished, in accordance with international best practice requirements.

The EBC understands that these licensing and tariff issues will be addressed in the new TBL, with many requirements being removed. This is a very positive step. However, the EBC also understands that non-dominant carriers may be defined as providing “universal services” (such as local call services) that may be subject to tariff filing. Although there is a clear need to control the tariffs of “universal services” in the interests of consumer protection, as a point of principle, there is no need for tariff control to extend beyond the universal service provider, that, in effect, is the dominant provider. Competitive carriers, who have no universal service obligation, should not have any of their portfolio designated as “universal services”.

Public Consultation Processes

The openness, fairness, and transparency of any “public consultation process” associated with the provisions of the new TBL, or any of its supporting ministerial ordinances, are issues of ongoing concern in Japan.

To open up the consultation process and make it fully transparent, it is advised that Soumusho, at a minimum:

- publish an annual management plan that gives consumer groups and the industry advance notice of consultation on issues that may affect them;
- issue a consultation document setting out its preliminary proposals on particular issues to draw in the views of the industry and the public. Consultation should take the form of an initial period for comments followed by a second stage of comments on the views expressed in the first round. All responses, other than those restricted on the grounds of commercial confidentiality, should be made available on the Internet;

- allow sufficient time for responding – current timeframes are too short in Japan (particularly for foreign carriers, given the need for translation). A minimum of 6 weeks should be allowed, although most developed countries with competitive telecommunications markets typically allow longer; and
- issue a statement setting out the results of the consultation process, responding to points made in the consultation process, and giving full and detailed reasons for decisions.

To give this process real meaning, “closed” processes should be abandoned, and the revised consultation process be used as the primary vehicle for policy making decisions.

4. Summary of Recommendations

Japan has the ability to significantly increase both the competitiveness of its telecommunications sector and the levels of foreign investment in that sector. But to unlock that potential, it is critical for regulatory reform to be introduced. The sooner these measures are introduced, the sooner the industry will grow. The new Telecommunications Business Law, and its supporting ministerial ordinances, provides a unique opportunity to achieve this.

The EBC strongly recommend that the following be incorporated into the new TBL and its supporting ministerial ordinances:

Dominant Carrier Regulation

- The new TBL must not restrict the dominance of NTT companies to be only where they have bottleneck facilities. The new TBL must incorporate an internationally accepted methodology for competition analysis and review (identification of appropriate market boundaries, and the identification of significant market power within those boundaries), to give the regulator the tools it needs for its ongoing competition and monitoring role.
- The new TBL must incorporate strong regulatory accounting and information disclosure requirements on the incumbent, and investigative powers on the Soumusho – to enable the anti-competitive conduct to be more readily identifiable and to enable regulatory processes to be based on rigorously gathered and transparently disclosed evidence.
- The new TBL must incorporate stronger “ring fencing” rules to prevent NTT from leveraging its dominance in the local loop into new business areas.
- The new TBL must incorporate an effective methodology to regulate all dominant carrier tariffs. The use of tools to monitor and prevent anti-competitive pricing by the incumbent

in fixed line services, such as OFTEL's "Stack Test", must be formal legal requirements for dominant carrier tariff approval.

- The Soumusho must be required, under the new TBL or its ministerial ordinances, to publish the results its investigations.

Regulation of NCCs

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- The new TBL should require the Soumusho to issue consultation documents setting out its preliminary proposals on particular issues to draw in the views of the industry and the public. Consultation should take the form of an initial period for comments followed by a second stage of comments on the views expressed in the first round. All responses, other than those restricted on the grounds of commercial confidentiality, should be made available on the Internet.
- The new TBL must require the Soumusho to allow sufficient time for responses to public consultations. A minimum of 6 weeks should be allowed, although most developed countries with competitive telecommunications markets typically allow longer.

EBC Telecommunications Carriers Committee

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