

**PROPOSED AMENDMENTS TO THE TELECOMMUNICATIONS BUSINESS LAW:  
EUROPEAN BUSINESS COMMUNITY (EBC) POSITION PAPER**

**July 2003**

**1. Introduction**

In its Position Paper dated March 2003 (*Issues and Priorities in Telecommunications Reform in Japan*) the EBC identified the over regulation of non-dominant operators and the under regulation of NTT as key factors inhibiting the development of effective competition in the Japanese telecommunications market.

The EBC welcomes efforts to lift some of the prescriptive regulation in the current regulatory framework including in areas such as licensing, market entry and exit, the granting of rights of way, tariff notification, service provision and accounting obligations.

However, the EBC is concerned that two aspects of the current proposals will make the current position worse, by:

- unnecessarily continuing prescriptive tariff filing and regulatory accounting obligations on non-dominant operators in some service areas; and
- removing necessary regulatory controls on the ability of NTT to abuse its dominance in order to prevent the development of effective competition.

This paper outlines the EBC's concerns and the measures the EBC considers should be taken to deal with them in accordance with international best practice requirements.

**2. POLICY OBJECTIVE OF ACCOUNTING SEPARATION AND TARIFF NOTIFICATION**

It is useful to begin by reviewing the underlying policy objectives of tariff filing and accounting obligations. These are intended to provide some limit on the ability of a dominant operator to abuse its market power by unilaterally raising prices and restricting output. These regulatory mechanisms usually seek to address three principal types of anti-competitive behaviour:

*Predatory pricing*

Predatory pricing is conventionally associated with below cost pricing by the dominant operator. The conduct usually manifests itself through aggressive discounting by the dominant operator or firm with significant market power in a manner designed to eliminate, prevent or damage a competitor in a market. The market power and financial resources of the dominant operator are

such that non-dominant operators are unable to match or compete with the discounting of the dominant operator and are forced to consolidate their position in the market, exit or choose not to enter the relevant market. Once competing operators have been excluded, the dominant operator is in a position to price to monopoly levels, to the detriment of consumers.

Requiring the dominant operator to file tariffs for its wholesale and retail pricing provides a mechanism by which the regulator can monitor the pricing conduct of the dominant operator and ensure that it does not engage in predatory pricing behaviour. It also has the effect of removing the ability of the dominant operator to discount selectively in order to damage its competitors.

Accounting separation is important as it provides the regulator with visibility of the transfer prices for services. This is a convenient and accurate measure of the underlying cost base of the services of the dominant operator. The comparison of the underlying cost base of a service with the price of the service is a critical part of determining whether particular discounting conduct is below cost and predatory.

#### *Price Squeeze*

Price squeezing conduct occurs where a vertically integrated operator, which is dominant in the upstream access market, charges its competitors a price for access that is too high for its competitors to make a sufficient margin having regard to prices for services in the downstream markets. Obviously, where there are competitive substitutes in the upstream market, there is no risk of price squeezing, as the competition between providers will ensure that the price for access is efficient. There is only a risk of such conduct where the upstream operator is dominant and when that operator also competes in the downstream market in such a way that it is able to manipulate prices in both markets to give effect to the price squeeze.

Tariff filing of retail and wholesale services limits the ability of a vertically integrated dominant operator to engage in price squeezing conduct because it provides transparency of its retail and wholesale prices and as such enables regulators to impute whether there will be a sufficient margin for competitors to operate a viable and sustainable business.

Accounting separation obligations are also critical for the reasons described below. It removes the ability of the dominant operator to price discriminate in an anti-competitive manner. That is, it lessens the ability of the dominant operator to charge inefficiently high prices for access to competitors as this conduct would be visible by virtue of the transparency of the price its charges its own retail operations.

### *Discriminatory pricing*

A vertically integrated operator that is dominant in the upstream access market has the incentive and the ability to discriminate between its competitors in the downstream market and its own retail operations. Where there is no dominant operator in the upstream access market, and there are competitive substitutes for access available, the incentive of a vertically integrated operator to discriminate is removed, as its primary focus would be pricing its access services at an efficient level given the risks of losing business and traffic to the competitive network.

Accounting separation is an important mechanism in preventing discriminatory pricing because it makes transparent the manner in which the wholesale or upstream operations treat the downstream or retail operations. This transparency means that any discrimination is easily detectable. This discourages the dominant operator from adopting anti-competitive discriminatory practices. It ensures that all competitors in the downstream markets, including the retail operations of the dominant operator, are treated in the same manner and accordingly compete on a level playing field.

### **3. APPLICATION OF TARIFF FILING AND ACCOUNTING SEPARATION OBLIGATIONS TO NON-DOMINANT OPERATORS**

Under the current proposals, tariff notification and regulatory accounting obligations will continue to apply for services categorised as “Universal Services” for all operators, including non-dominant operators. “Universal Services” are defined to include subscriber line services, local call services, public payphone services and emergency call services.

The EBC considers that these obligations should only apply to NTT East and West, as the dominant operator, and objects to their continued application to non-dominant operators.

As is demonstrated in the discussion above, the primary policy objective of tariff filing and accounting separation is to regulate the potential anti-competitive conduct of the dominant operator. No economic or legal policy objective is achieved by applying the same regulatory regime to non-dominant operators. The very conduct that the tariff filing and account separation regimes are intended to address can only, by its very nature, be engaged in by the an operator with *dominance* in a market. Non-dominant operators cannot engage in this conduct because they are always constrained by their competitors.

Imposing tariff obligations and accounting separation obligation impact significantly upon the ability of non-dominant operators to compete with dominant operators. For example:

- The cumbersome and time consuming process of filing a tariff notice of a tariff change restricts the responsiveness of non-dominant operator's pricing to the needs of consumers.

- Tariff filing makes the non-dominant operator's pricing transparent to the dominant operator and makes it difficult for the non-dominant to compete with the dominant operator in relation to price.
- Tariff filing imposes significant regulatory costs on non-dominant operators.

The inappropriateness of regulating non-dominant operators in the manner proposed is evidenced by the regulation of non-dominant operators in other jurisdictions. For example:

- Hong Kong and Singapore do not require that a non-dominant carrier price in accordance with published tariffs.
- In the United Kingdom non-dominant operators do not have to price services in accordance with published tariffs.
- The new European regulatory framework prohibits the imposition of obligations such as accounting separation and the notification of tariffs<sup>1</sup> on non-dominant operators.

**Box 1 – Tariff case study – EU**

The Access Directive provides that national regulatory authorities shall not impose the obligations set out in Articles 9 to 13 [Obligation of transparency, Obligation of non-discrimination, Obligation of accounting separation, Obligations of access to, and use of, specific network facilities, Price control and cost accounting obligations] on operators that have not been designated in accordance with paragraph 2 [operators designated as having significant market power].

In relation to accounting separation, the EU prohibits national regulatory agencies from imposing accounting separation on non-dominant operators, and Australia and Singapore impose significant accounting separation obligations only on dominant operators.

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<sup>1</sup> Article 8(3) of the Access Directive – Directive 2002/19EC of the European Parliament and of the Council of 7 March 2002.

#### **Box 2 – Accounting Separation in Australia**

In Australia, the Telecommunications Competition Bill 2002 imposed a requirement on the Minister for Communications to issue a direction to the regulator, the ACCC, requiring Telstra, the dominant operator, to separately account for its retail and wholesale divisions. This has been done through the Australian Competition and Consumer Commission (Accounting Separation - Telstra Corporation Limited) Direction (No. 1) 2003. This requirement is not imposed on non-dominant operators.

It is clearly inappropriate for tariff filing and accounting obligations to be imposed on non-dominant operators where such an obligation is inconsistent with international best practice and would result in substantial damage to the process of competition.

#### **4. DESIGNATED AND SPECIFIED SERVICES**

The proposed amendments recognise that certain categories of fixed line services are not yet effectively competitive and that continuing regulatory controls are required on NTT. This is reflected in the concept of Designated Services.

"Designated Services" are defined as "services that use NTT East and West's bottleneck facilities which are not sufficiently provided by competing operators". NTT will be required to comply with a "Guarantee Clause" given to Soumusho in respect of any Designated Services. This Guarantee Clause will provide minimum consumer guarantees in relation to each service. The exact content of the minimum guarantee is unclear.

It appears from the proposals that NTT East and NTT West will be required to notify tariffs in respect of Designated Services but will not be required to price at the notified tariffs. The effect of this is to impose no restriction on the pricing conduct of the dominant operator and accordingly causes the tariff filing obligation to be of no practical consequence.

For the reasons described above, appropriate tariff filing and accounting separation are important regulatory mechanisms to prevent dominant operators from lessening the ability of their competitors to compete effectively in downstream markets or otherwise damaging the competitive process. Allowing NTT to price off tariff will greatly increase the ability of NTT to engage in such anti-competitive conduct.

Designated Services identify those services that are supplied by NTT in the absence of adequate competitive restraint. NTT maintains a position of dominance in the supply of those services. Having recognised the absence of competitive restraint it is imperative that appropriate regulatory mechanisms be put in place to assist in preventing NTT from engaging in conduct which takes advantage of this lack of competitive restraint to the detriment of all other competitors and the competitive process. For the reasons discussed above, such appropriate regulatory mechanisms include obligations to notify and price on tariff and suitable accounting separation requirements.

The importance of imposing appropriate regulatory restrictions on dominant operators has been recognised by the EU. The Framework Directive provides that where a national regulatory authority concludes that an operator has significant market power (dominance) they *must* impose on that operator certain types of regulatory obligations.<sup>2</sup> These include accounting separation and tariff filing obligations.

In the United Kingdom, the dominant providers, BT and Kingston, currently have conditions relating to tariff notification in their licences, requiring them to provide advance notice of price notification and maintain a published price list for all services provided by those companies.

**Box 3 – Dominant Licensees in Singapore**

Under the Code of Practice for Competition in the Provision of Telecommunications Services, a Dominant Licensee must file its tariffs for all services provided by it, for approval by the Info-communications Development Authority (IDA) and must publish those approved tariffs. The tariff must include a clear statement of the prices, terms and conditions on which the service will be offered and any discounts or special conditions must be listed. The licensee must then comply with the published rates. Where a dominant Licensee develops an offer to meet the need of a specific end user, it must file a tariff embodying that offer, and must make those prices, terms and conditions available to any other end user upon request, subject to reasonable modifications.

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<sup>2</sup> Article 16(4) of the Framework Directive – Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002.

## 5. CONCLUSION

For the reasons given above, the EBC considers that:

- All tariff filing and regulatory accounting obligations should be lifted from all non-dominant operators in relation to all types of services. This is because such regulation serves no apparent purpose yet causes significant competitive detriment to non-dominant operators.
- NTT should be subject to a requirement that it notify and price on tariff and maintain regulatory accounts in respect of all Designated Services. To do otherwise would ignore the consequences of the very finding that the service is not subject to any effective competitive restraint.

**EBC Telecommunications Carriers Committee**

**July 2003**