



Submission:

**Regulatory institutions and practices
– the issues paper responses to
Questions**

October 2013

KLR background

KLR is a part of the KLR HK group, a foundation investor in Two Degrees Mobile Limited, New Zealand's third mobile operator.

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Introduction

Thank you for the opportunity to comment on the review of regulatory practises ,much of the KLR response is from the perspective of a telecommunications entrepreneur and investor in NZ telecommunications infrastructure .

NZ has lagged behind the rest of the world in developing competition in its wireless markets. This is because until as recently as 2009, the NZ regulatory environment was behind the rest of the world (reference 2008 ComCom Market Monitoring report – pg 21- illustrating pricing being on average 30% higher than other OCEDs)

KLR believes effective & sustainable competition does not exist in many capital intensive sectors in NZ because of a lack of effective regulation in facilitating competition, Governments break up monopolies – the private sector preserves them .

Too often NZ regulators ComCom included are captured by lobbyists who convince them that NZ is too small for competition and consumers are better off with one or 2 large players .

The core messages of this submission are

- NZ regulators are disgracefully weak at peer group analysis of countries that have similar characteristics of NZ *(Ireland , Sweden , Denmark , Norway) and other EU countries
- NZ regulators are very weak at understanding game theory – and the impact that weak generic competition law (ie Section 36 of Commerce Act) has on this .
- NZ regulators (particularly ComCom & MBIE) are poorly skilled and have little experience in peer group markets (
- A long list of mistakes and “out-gamed “ regulators make for embarrassing contribution to the productivity of NZ

WHAT THE PRODUCTIVITY COMMISSION MUST DO TO IMPROVE REGULATORY PRACTISES IN NZ

1. Ensure that 30% of all professional staff in NZ regulators has had at least 2 years experience in international peer group regulatory offices
2. Consider completely outsourcing some regulatory functions to Australian or EU regulators with guidance on what needs to be achieved
3. Aggressively bench mark progress of regulators to international or EU best practice

A comparison of the NZ telecommunications regulatory regimes and a comparison against its international peer group would illustrate the following

1. Some substantial mistakes relative to NZ's international peer group in setting competition – meaning that significant incumbency advantages were allowed to perpetuate.
2. Some of the worlds worst spectrum outcomes permitted which meant that the foundation of the wireless industry in NZ is skewed towards one operator having complete dominance
3. Basic international initiatives like 3rd party cell tower companies , effective competition in business markets and fixed to mobile substitution have not occurred in NZ
4. A desperately poor understanding of the industry and a history of the regulator and relative Ministers of the Crown being gamed
5. Dominant players not having to disclose their financial structure to the regulators

“**Angel & Walden**” academics in 2002 published Telecommunications Regulation. It profiled the differences in international regulatory environments which were designed to created competition and in it New Zealand was described as “*largely regarded as a disaster*”.

KLR doesn't have a rugby box. This box is a summary of messages that would be delivered if KLR had a sports box and were engaging (capturing) with Politicians & MBIE officials.

- 1) NZ pursued a substantially different regulatory regime for over 2 decades and until the 2010 Telecommunications Act, NZ telecommunications was largely in the hands of monopolist structures.
- 2) NZ's peer group of countries pursued a licensing of mobile phone carriers where specific licenses, including spectrum, interconnection, co location, and various market protocols were included.

NZ just sold raw spectrum and forced the carriers to negotiate all these related interconnection matters separately. This tipped the balance of power to the incumbents who had all the market power and forced new operators to have to beg in public for the regulator to intervene for over a decade. This illustrates a substantially different approach in regulation which impacts consumers to this day

- 3) The Commerce Commission have made a substantive error in reporting the level of competition in the mobile market which means the market structure is actually less competitive than reported. This dominance of the incumbents can merely be perpetuated in a new spectrum sale. Voda and Telecom are not equal. Voda NZ has approximately 55% revenue market share and Telecom 34% revenue share. Voda came to NZ when the penetration of Mobile was less than 15% and NZ was the only country to have only one GSM operator. It's a capital intensive fixed cost business so market share and HHI ratios do matter
- 4) These errors are important to understand when considering spectrum sales because the sale of new spectrum is a legitimate regulatory opportunity to reset competition platforms and conditionality around the use of a government asset (spectrum).
- 5) ***If the MBIE, ComCom & The Treasury are confident that their policy is so world class, why don't they put it out to other regulators for peer group review? (there is a group of regulators who have similar sized markets which similar sized GDP such as Denmark, Sweden , Norway and Finish regulators who cold offer this).***
- 6) ***The policy as it stands will allocate perpetual spectrum superiority to Vodafone in return for more rural indulgence*** and the long term market effect will be city based consumers cross subsidising rural customers because of the Competition agencies MBIE & ComCom unwillingness to re-align NZ's spectrum allocation process to international best practise.

THE QUESTIONS ANSWERED BY KLR

Q1 : What sort of institution arrangements and regulatory practices should the commission review .

The Commission should review telecommunications regulatory practices in NZ because it has such a significant impact on the level of ,pricing for consumers , businesses and innovation that directly impacts productivity , Independent consultants illustrated that competition in mobile delivered economic benefits in excess of \$NZD 2billion to NZ .
<http://www.2degreesmobile.co.nz/mobilecompetition>.

Competition is still not established in NZ as illustrated by many benchmarks ,and 2degrees mobile is yet to become profitable . , Much needs to be fixed in telecommunications regulation as illustrated by the Copper Tax campaign

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

- Basic guidelines on international benchmarking for regulatory practices and that of measuring competition
- Standards for increased training of NZ regulators
- Policy frameworks on the level of domestic competition in NZ

Q3: Does NZ have a unique “regulatory style” as a result of our specific characteristics.

Yes traditionally NZ has been self regulatory orientated , free market and has been late to introduce basic international practises (for example Telecommunications regulation only came to NZ in 2007 , when the rest of the world benefited from it in the late 1980s .

Self regulatory groups are created by the large companies in sectors and often work counter to the interests of consumers and competition. An example of this is the Telecommunications Carrier Forum, (TCF) ,essentially it’s a big boys club and its board is dominated by the voting power and resources of the 2 big carriers . It carries out administration functions often which impact on competition, thereby marginalising smaller carriers. BRANZ domination by Fletchers is also worthy of a review .

Q4: What Influence has NZ specific characteristics had on the way regulation is designed and operated in NZ .

NZ thought it was different from the rest of the world and had invented a new type of economics in the 1980s and those large corporate interests were aligned with kiwi consumer interests, the isolation of NZ prevented NZ regulatory institutions from developing similar to international groups. What

needs to happen is a catch up program needs to be developed whereby historical errors and im-balances can be fixed.

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 regulation regime

1. Current review of Copper pricing by MBIE
2. The MBIE handles Spectrum sales in NZ , rather than the ComCom – most international environments has the teleco regulator handle spectrum not the policy maker
3. The MBIE delivered a Rural broadband subsidy to the incumbent Vodafone , which conflicted with the ComCom’s role in creating competition

Q19: is regulatory capture more or less likely in a small country ? can you provide examples of capture in NZ

Yes regulatory capture is alive and well in NZ

Example of regulatory capture in telecommunications	Comment	Impact
Delay of unbundling local loop & 0867 fisaco	NZ is late to develop ADSL technologies and has dominance by telecom perpetuated	Lack of innovation in the 2000s and high prices and low investment
Co location of cell towers is gamed by the incumbents in 2001 -2008	A serious barrier to entry means new operators are quarantined	Still 10 years later cell tower policy in NZ is a mess
High spectrum costs for new operators	Incumbents force up spectrum pricing to quarantine new entrants	Incumbents game regulators to perpetuate their dominance
Dominant players “buy off competition		
Failed competitors (Telstra NZ) are able to be purchased by incumbents to further entrench dominant players	A failure to understand market dynamics means failed competition policy is covered up by an acquisition	Consumers suffer
Govt invests in fibre to the home	The govt have a vested interest in leveraging their position as the regulator	
All the 900mhz spectrum is allocated to Voda for a decade	a new entrant can only start when a regulator intervenes	A late start in industry development means substantial problems in the development of effective competition
BRANZ domination by Fletcher building	This is an an example where a regulatory group is overwhelmed by a large vertically integrated dominant company	Govt think self regulatory is working – its only working for large dominant corporates

Q27 Can you provide examples where the review and Appeals processes provided for are well matched or poorly suited to the nature of regulatory regimes?

Schedule 3 regulatory processes under the 2001 Telecommunications Act means that nearly 3 years is needed to provide must have regulatory solutions , therefore they are gamed and incumbents string out matters for a further 3 years .

Q28: What are the advantages and disadvantages of a general merits review body like the Australian system

Big players stall small competitors –and delay competition and perpetuate monopoly rents and productivity inefficiency.

Q34: What approaches are there to identifying, building and maintaining workforce capability? How effective have they been ?

Its KLR's experience that there are some outstanding committed individuals in the NZ regulators, however they are not given the institutional support to develop their skills or the training required. They must be given the opportunity to travel and train internationally.

Q 35 : What restrains or enables a regulator to develop the capability they need in the NZ context?

Ability to benchmark against other peer group countries, (Ireland Denmark , Sweden, Norway) and international best practise , USA, UK , Germany et al.

Q 36: Where are there gaps in regulator workforce capability? can you provide examples

Economists on game theory, - (kiwi regulators get gamed by the large NZ & international corporate)

NZ regulators behave like pre-school children when it comes to being gamed, (example spectrum sales, Competition policy building industry , investment dynamics (*please call me 0222 222 222 to discuss further examples*) .

NZ regulators need to hire game theory economists, to better figure out how to deal with large corporate that generally rivet them over .

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

Combining regulators is dangerous because of specialist skills needed in capital intensive large industries

Q 40: Do NZ regulators have access to sufficient range of enforcement tools ? If Not what evidence is there to suggest that a broader range or tools would promote better regulatory outcomes .

No this is because NZ competition law doesn't have a definition of SMP (significant market power)

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

MBIE makes telecommunications policy to suit the government of the day , they can over –rule the ComCom , this means that politics and Ministers have too much power (and too little knowledge)

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

Too much consultation is required in telecommunications sector . too often to achieve regulatory solutions are sorted in sequence rather than several matters sorted in a parallel process this slows down industry development .

Q49: How best can the challenges of working in partnership with Maori be met by regulatory agencies? what models , methods and approaches are most successful ?

KLR thinks there is such a powerful Maori machine in NZ , that no one wants to critique Maori Inc NZ .

Its KLR's view that Pan Maori Groups have different styles from Iwi Investment Groups . Iwi investment groups behave like rational investors and are similar to investors anywhere in the world. Whereby Pan Maori groups are usually focused on treaty related settlement matters and are occasionally gamed by the Governments into accepting token board memberships, and lanyards instead of really using their leverage secure proper benefits.

Its KLR's perspective that the most successful regulatory solutions for Maori is where they have been incentivised to work on the *business case* and bring about international best practice to NZ and assist in breaking monopolies

Q52: can you provide examples where the culture within a regulator supports or inhibits staff in making unwelcome decisions to the government regulated parties or public ?

ComCom on unbundling in 2004

MBIE Spectrum policy

Q 53 :can you provide examples where a regulator places too much value on management risks to itself , relative to other priorities (such as the regulatory objective or customer service) – what are the consequences

ComCom's failure to take a more aggressive approach with the weaknesses of Section 36 of the Commerce Act and related failures

A summary of KLR's position on the regulatory issues paper process is as follows:

Consultation item	KLR response	Comment
Skills of the NZ regulators	Generally weak -	There is an absolute lack of international benchmarking and skills transfer taking place
Regulatory capture	disgraceful	The NZ taxpayer is subsidising one of NZ's most profitable companies with the RBI (rural broadband subsidy) - the MBIE has and ComCom have been gamed into using misleading indicators in the industry
Failure to benchmark effectively	Worlds worst practices occur in NZ	It seems like NZ regulators don't know how to use a plane , or the internet , because NZ comparisons with worlds best practices are so weak
Partnership with Maori	No one wants to critique Maori groups in NZ	KLR things there is a massive difference between "well capitalised Iwi groups & and Pan Maori groups set up by governments to solve political problems . Maori seems unwilling to engage in international benchmarking
Regulatory effectiveness in NZ	KLR's experience of teleco regulation is disgraceful	A insulate culture , captured by large business means poor benchmarking and poor decisions
Progress NZ Inc has made to stimulating domestic competition	Its failed	NZ regulators can't even calculate a HHI ratio ,
Telecommunications review	Minister fails to find out the true level of profitability of the incumbent before explaining that there is only room for 2 players	The telecommunications minister embarrass her ministry to making judgements without the right information or correct financial analysis of the industry

Summary of Key Points

- There is significant confusion between the ComCom and MBIE with regard to telecommunications regulation
- NZ was 15 years behind the rest of the world in adopting telecommunications regulatory practices , the legacy of this lateness needs to be comprehensively studied and the impact assessed.
- The intervention by the MBIE with "guidance on what the copper pricing should be is an example of political interference with the regulatory process
- The lack of benchmarking with NZ's peer group of countries in telecommunications is a state disgrace.
- Regulation in many commercial areas is not brain surgery, its merely getting international best practices and standards and introducing them to NZ - Too often this practises are not identified or are avoided because the regulator is captured by large business interests.

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