

# Appendix B – Comments on Telecommunications Regulatory Guidance Principles Proposed by TELUS

Dr. Johannes M. Bauer

September 15, 2005

1. TELUS' proposal makes many valid points and contains good suggestions. It is a matter of good public policy to require that regulation be effective, cost-effective, timely, transparent, and that regulators are held accountable for their performance.<sup>1</sup> Moreover, regulatory symmetry is a desirable feature. Furthermore, in some areas it is sensible to rely on ex post forms of regulation combined with improved and more powerful enforcement tools for the CRTC.<sup>2</sup> Several of the ten principles proposed by TELUS<sup>3</sup> deserve full or partial support. The following comments assess the proposed principles from the standpoint of regulatory economics and public policy analysis.

***Principle 1:***      **The key premise underlying Canada's approach to telecommunications regulation should be that market forces should be relied upon to the greatest extent possible to achieve Canada's policy goals for the telecommunications sector.**

2. It is reasonable to rely upon market forces if they are capable of achieving the objectives of Canadian telecommunications policy. However, care is necessary when assessing the effectiveness of market forces. A general endorsement of market forces cannot mean a blank check in favor of unfettered competition regardless of market conditions. Rather, it is necessary that the conditions for effective competition are in place.
3. One of the critical areas in which such decisions are currently at stake is local exchange markets. The best indicators of effective competition are actual market and firm performance data. Unfortunately, such data is generally not available at the time of adoption of regulatory reforms. The information will only become available after a reform, such as a measure of forbearance, has been adopted. Regulatory reform will therefore have to rely on second-best indicators, such as market shares or shares in access lines.
4. Whereas such structural indicators are not ideal, they cannot be avoided at the time of reform. Any decision to eliminate regulation and rely on market forces is afflicted with uncertainty. There are two principal options: (1) a leap-of-faith-approach without a safety net in case the expected competitive structures do not materialize, or (2) an approach that releases market forces while establishing safeguards in case competition does not evolve as anticipated. The second approach has the advantage of realizing

---

<sup>1</sup> Telecommunications Policy Review, *Submission of TELUS Communications Inc.*, August 15, 2005, paragraph 13.

<sup>2</sup> *Ibid.*, paragraph 58.

<sup>3</sup> *Ibid.*, paragraph 60.

benefits from competition while providing an assurance against failure. In contrast, the first approach is a bet that a second-best indicator of future competition is a reliable predictor of future market developments. Given the relatively poor record of forecasting the evolution of competition in local and other telecommunication markets, this seems a high-risk endeavor without any easy option to correct mistakes (competition review may be insufficient to correct possible mistakes).

***Principle 2:***        **The presumption should be that market forces are capable of providing the requisite level of discipline and regulation should only be applied when it is credibly demonstrated that market forces alone cannot be relied upon to achieve the stated policy goals.**

5. TELUS' submission is based on a narrow notion of the role of regulation and how it interacts with market forces that overall, leads to wrong conclusions. This is, for example, evident in the 1984 quote by Dr. Alfred E. Kahn that there is "no rational halfway house between thorough regulation and free competition."<sup>4</sup> During the past 20+ years, regulation has changed significantly from a substitute of competition in monopoly market segments to a complement of competition in partially competitive market environments, such as advanced telecommunications (but also energy markets).
6. The historical record during the past decade demonstrates that countries that have designed regulation to facilitate and support market forces have made the most rapid progress. Canada's challenge is not to eliminate regulation altogether but to modify the existing approach so as to harness advanced communications technology to its fullest. Reliance on market forces and competition will lead a long way towards this goal. However, where market forces are insufficient or lead to outcomes that are not in the public interest, enlightened policy intervention, including regulation will be needed.

***Principle 3:***        **Economic regulation should only be applied to essential services and then only where providers of those services possess non-transitory market power.**

7. It is not self-evident why economic regulation should only apply to essential services. A standard that limits regulation to essential services is exceptionally vague. There is no unambiguous way of delineating essential from discretionary services. In an environment of 24/7 connectivity, services that may have been considered non-essential in the past, such as voice mail or call forwarding, may become essential. A more clear-cut approach to delineate services subject to regulation from those not subject to regulation is the competitive situation in the respective market.
8. If services are offered in a non-competitive markets but considered non-essential, forms of regulation that provide maximum flexibility to the service provider might be used. Moreover, in such instances, regulations should be applied symmetrically to any service provider. In any case, the classification of services as essential and non-essential would have to be reviewed periodically.

---

<sup>4</sup> *Ibid.*, paragraph 44.

9. Moreover, it is important to keep in mind that economic regulation not only addresses issues of market power but also other forms of market failure that may be present in telecommunication markets. These include the public good character of some of the benefits of telecommunications services or positive externalities associated with open and transparent interfaces and network platforms.

***Principle 4:* Economic regulation, where required, should neither exclude efficient competitive entry nor promote competitive entry artificially.**

10. This is a reasonable principle. It requires that prices for regulated services are set at an appropriate level. Thus, regulators should not give in to the temptation to set prices above such a reasonable standard to accelerate the entry of competitors. Likewise, regulation ought not to support competition artificially by keeping prices for essential facilities below a reasonable cost standard. If such measures in support of new firms are deemed necessary, they could be implemented through other means, including tax and subsidy policy.

***Principle 5:* Where economic regulation is deemed necessary, the regulated companies must be provided with a reasonable opportunity to recover their not imprudently incurred costs of providing the regulated services.**

11. This has been a fundamental principle of economic regulation for decades and requires no further discussion. Paradoxically, the principle is easier to implement in an environment of cost-plus regulation.

***Principle 6:* Social policy regulation and technical regulation, where required, should be applied symmetrically and should be applied through laws of general application, as distinct from sector-specific regulation, whenever possible.**

12. Whether social goals and technical objectives can best be achieved through laws of general application or not should be subject to a comparative efficiency assessment. Given social and technical policy objectives, the most efficient approach should be chosen. In some cases this might be laws of general application but in other cases such laws might be an inefficient solution. Stating an a priori preference for general laws is, therefore, not good public policy.

***Principle 7:* Where economic regulation is required, it should be applied symmetrically so as not to distort the efficient choice of either service provider or technological platform.**

13. Some forms of economic regulation (for example measures related to significant market power) are by their very nature asymmetric. However, they should be, as far as possible, applied independently of the technology platform or the provider. Another form of symmetry is important: regulatory reform must not be a one-way street toward deregulation independent of market developments. Should market segments become highly concentrated due to mergers or consolidation, a rational regulatory framework

would provide for the re-imposition of regulation, subject to the test stated in the comments to Principle 8 below.

**Principle 8: Regulation, where applied, should be both justified, in the sense that the benefits of regulation outweigh the cost of regulation and proportionate, in the sense that it that it is the least-intrusive form of regulation consistent with achieving the stated policy objectives.**

14. The principle addresses an important issue, although it will need to be generalized and restated in a dynamic fashion. Oliver Williamson formulated an important “remediability criterion”, requiring that an alternative state can only be considered superior if it is more efficient than the status quo and if there exists a transition path from here to there.<sup>5</sup> As is recognized by a significant amount of research, corroborated by practical experience, institutional arrangements (e.g., regulation, markets, hybrid approaches) can only be evaluated in a comparative fashion. Thus, the task is not to demonstrate the regulation has net benefits but to reach the conclusion that an alternative state (say unregulated markets) has higher net benefits and that the cost of reaching that state do not outweigh the increased benefits of that new state.
15. It is challenging to make such broad assessments. A better strategy therefore might be to require that changes in the regulatory regime (be it more or less regulation) yield net benefits and are designed in a way to maximize those net benefits. In this context, it is important to evaluate the direct and indirect benefits as well as the direct and indirect costs of regulation or alternative approaches.
16. With regard to the “least intrusive” criterion, it should be noted that a better standard would be to require that regulatory instruments are the most efficient to achieve the stated policy objectives. If there is an arsenal of equally efficient instruments available, it will be most compatible with the spirit of a free market economy to rely on the least intrusive instrument.

**Principle 9: Once it is credibly demonstrated that regulation is required, some form of *ex post* regulation should be adopted as a default. If and only if it is credibly demonstrated that *ex post* regulation fails to achieve the stated objectives should some form of *ex ante* regulation be considered.**

17. There are no strong reasons to prefer *ex post* regulation over *ex ante* regulation in general. As it may be difficult to create an information record, reliance on *ex post* regulation could lead to complex and cumbersome procedures, whose cost may outweigh any initial advantages. A similar disillusionment happened after the introduction of price caps: whereas there were high hopes that they would reduce the administrative burden and simplify regulation, in many countries this expectation did not materialize. Moreover, most forms of regulation combine *ex ante* and *ex post* components. The real question is to find an appropriate mix of *ex ante* and *ex post* measures where regulation is

---

<sup>5</sup> Williamson, O. E. (2000), “The New Institutional Economics: taking stock, looking ahead,” *Journal of Economic Literature* 38:595-613

warranted. Rather than requiring a preference for ex post regulation, the requirement should be that regulation is incentive compatible, that is, creates the correct incentives given the goals of telecommunications policy.

18. Having said this, it may in many cases be justified to rely more strongly on ex post design features. For example, price cap compliance is often better achieved ex post than ex ante. One of the strongest reasons for strengthening ex post components is that the regulatory agency may have insufficient information to adopt an efficient ex ante approach. It is also possible that the regulatory agency is captured by one of the stakeholders, such as the incumbent service provider or a new entrant.
19. Ex post regulation has the advantage that it enables suppliers to experiment with innovative business models. It also has the desirable feature that it generates actual performance data that may be used to evaluate the success or failure of a regulatory reform measure. (In this sense, the proposal by the Consumer Groups to introduce safeguards when forbearing from the regulation of local services is a form of ex post regulation, as it only is triggered if certain expectations are not met.)
20. Where ex post regulation can be used effectively, it is necessary that the CRTC has sufficient enforcement power, including the ability to impose economically relevant fines.

***Principle 10:* Regulatory decisions are reviewable by the courts and the Governor in Council to ensure compliance with the statute.**

21. It is desirable to allow for the review of regulatory decisions but it is important to design this review in the most efficient way. The experience around the world demonstrates that regulation is more efficient and effective if the regulatory agency is truly independent of day-to-day politics.<sup>6</sup> Giving review powers to the executive or the legislative branch of government would undermine this principle of regulatory independence.
22. In an appropriate division of labor, the executive should set the basic goals of telecommunications policy, the regulatory agency should implement and enforce them, and the courts should review them. Thus, the power to review regulatory decisions should rest with the courts rather than other branches of government.
23. Countries and regions differ with respect to the review powers given to the courts. For example, in the U.S., judiciary review goes beyond the procedural issues of a case and courts often change a regulatory decision in substance. In the European statutory legal system, court review tends to be more focused on procedural issues.

\*\*\* END OF DOCUMENT \*\*\*

---

<sup>6</sup> See, for example, G. Edwards and L. Waverman (2004), "The Effects of Public Ownership and Regulatory Independence on Regulatory Outcomes: A Study of Interconnect Rates in EU Telecommunications", working paper, London Business School, September.