NTC Consultative Document
On the Development of a Competition Policy Framework
For the Information and Communications Technology Sector

I. Introduction

The Philippine telecommunications industry marks its first decade of market reform this year. It was March 1995 when the Philippine Congress passed Republic Act (R.A.) 7925, otherwise known as the Public Telecommunications Policy Act of the Philippines which paved the way for opening the telecommunications market to competition. Then and now, R.A. 7925 is considered a landmark law that transformed a vital and strategic industry, and inspired similar reforms in other sectors, notably banking, shipping, downstream oil and power. And, despite limitations that have become apparent only years subsequent to its passage, R.A. 7925 is still credited for breaking away from the growth-stifling tradition of monopoly, public sector provisioning, and heavy-handed regulation.

It is also instructive to be reminded at the onset that when the Philippines launched its reform of the telecommunications sector, there were few experiences to draw from. The Philippines was among the first 11 countries to have permitted competition in fixed line network, and among the first 14 countries to have de-monopolized the international telephone service. Moreover, except for Chile and the Philippines, the league of early reformers was composed of developed economies. In other words, the Philippines had to break new ground in designing a reform framework appropriate to the condition and needs of a developing country.

The achievements of the past ten years following the passage of R.A. 7925 are undeniable. Access to telecommunication services has grown many folds than initially anticipated. Investments in the sector defied the sluggish growth in the rest of the economy, and indeed, continue to drive the prospects for future economic growth.

Yet, it is equally clear from the massive underutilized infrastructure and the debt burden amassed by Philippine carriers that entry and competition could have been managed more effectively.

For one, the reform blueprint attempted to push universal service by practically leaving the market to its own devices, challenging the conventional view that such could be more viably achieved through public investments or regulator-directed private investments. The result was a concentration of access to telecommunication services in urban and relatively higher income areas which highlighted the inherent contradiction and tension between promoting competition on the one hand, and relying on cross-subsidization of services to finance universal access, on the other.

Morevoer, a key issue faced by policymakers when they break up a monopoly is determining the optimal number of new players that would be allowed to challenge the incumbent. Too many entrants could lead to ruinous competition and socially wasteful duplication of investments. In this instance, while such risk is not lost to policymakers, the reform blueprint nonetheless accommodated the entry of nine new carriers, a number that some consider too many given the size of the market. Today, there is widespread apprehension on the effectiveness and sustainability of what appears to be competition among a relatively large number of service providers in the market.

Finally, it must be pointed out that beyond the spheres of law and policy, technological developments that were not anticipated at the time R.A. 7925 was passed, continue to move forward at a rapid and dizzying pace. Emerging technologies and applications made possible by the rapid developments in the telecommunications sector (such as VOIP, wireless technologies and other opportunities opened by convergence) increasingly handicap the NTC as it struggles to provide appropriate responses to the needs of the sector and demand of the public for competitively priced and wider array of goods and services.

The Commission therefore views the development of such a competition policy framework as timely and as an affirmative duty mandated by law. Such a framework is necessary to correct the flaws in the regulatory environment that restrain competition and prevent the efficient functioning of the market. It is an important step that will guide future initiatives and decisions of both the Commission and the private sector as they contemplate competition-related issues.

A Competition Policy Framework for the sector is perhaps long overdue given that the Commission has long defined its vision "as a proactive regulatory agency" committed to promoting "a globally competitive, universally accessible and affordable information infrastructure and services." Indeed, a competitive market is acknowledged the most efficient mechanism for developing a modern, ubiquitous and affordable information infrastructure, but past regulatory regimes were not prepared to assume this strategic role.

The Commission envisions that the framework development will proceed in three phases:

?? **Phase One** identifies and validates the imperatives for a competition policy framework and the fundamental changes in regulation that the Commission ought to pursue.

?? **Phase Two** examines in detail key competition issues bearing on the sector, including, in particular, pricing, interconnection and spectrum management.

?? **Phase Three** consolidates the outcomes of the consultations in the preceding phases into a coherent and comprehensive policy framework.

It must be emphasized that the Commission will involve and actively encourage the full participation of all stakeholders, particularly from the private sector and civil society, in all phases of this very critical initiative.

It is in the spirit of transparency and openness, therefore, that The National Telecommunications Commission (hereafter Commission) now invites public comment on this **Consultative Document on the Development of a Competition Policy Framework for the Philippine ICT Sector,** as the first step towards the development of the policy framework for competition in the information and communications technology sector. In the main, it covers:

?? A review of **four market trends** deemed to impinge on current and future state of competition in the sector;

?? An exploration of **four major policies** that may change the balance of market power, hence the nature and degree of competition;

?? An assessment of the quality of current regulation, identifying **four major handicaps** of the Commission; and

?? A discussion of **four urgent tasks** for the Commission to effectively govern a dynamic and complex industry.

Comments from industry stakeholders and other interested parties in relation to any and all issues raised in this Request should be sent (in both hard copy and electronic formats) on or before January 31, 2006 to:

Office of the Commissioner
National Telecommunications Commission
BIR Road, East Triangle, Diliman, Quezon City

All Comments will be made publicly available at the NTC and shall be posted on the NTC website (www.ntc.gov.ph).

II. Four Apparent Trends Defining the State of Market Competition

For purposes of assessing the state of competition, the Commission simplified its definition of the telecommunications market as being comprised of three submarkets: fixed line, mobile, and internet and data services.

The goal of the Commission is to ensure that competition in all three submarkets is **effective** and **sustainable**.

Competition is deemed effective when existing and/or potential service providers have the capacity to prevent an incumbent provider from using its market power to keep prices above underlying costs over a considerably long period. Thus, the effectiveness of competition is unrelated to the actual number of service providers in the market, for a market with a single service provider could be just as competitive as one with several providers. **What is important is that the threat of actual or potential competition is sufficient to discipline the behavior of the incumbent.** This therefore requires competitors to hold reasonably strong market position such that the incumbent cannot ignore the impact of their possible response to any anti-competitive conduct on its part.

A sustainably competitive market, on the other hand, may be viewed at two levels. One is the capacity of existing providers to remain viable in the long run and hence to pose continuous market challenge to the incumbent. It requires competitors to hold reasonably secure market positions that can likely endure competitive challenges from the incumbent. At another level, sustainability pertains to the ability of market forces to maintain a competitive environment even after regulation has been removed. That is, competition is truly sustainable if it persists even under a deregulated environment.

> Question 1: Do you agree that the effectiveness and sustainability of market competition should be the overarching goal of the Commission? Is there other higher goal that should guide the Commission's undertaking?

At least four apparent trends suggest to the Commission that competition in all three markets is neither effective nor sustainable.

Trend 1: Several licensees have emerged dominant and financially viable in the submarkets, while the market shares of the other licensees have been reduced to almost insignificant levels. These other licensess are thus unable to pose effective competition against the dominant providers.

The Commission records show that since market liberalization, the number of service providers in most market segments is either increasing or relatively stable. As of the end of 2004, there were 73 local exchange carriers (LECs), 14 inter-exchange carriers (IXCs), 11 international gateway facility (IGF) operators, 5 cellular mobile telephone service (CMTS) providers, and 329 value-added service (VAS) providers, of which 43 are internet service providers (ISPs). In 1999, the numbers were not too different except for VAS: 76 LECs, 12 IXCs, 11 IGF operators, 5 CMTS providers, and 106 VAS providers, of which 31 are ISPs.

A mere headcount of service providers, however, misrepresents the true state of competition in the ICT market. While the Philippines has one of the highest number of service providers per capita, only a handful of these licensees are effectively competing in the market.

An analysis of the available data[1] reveals that the LEC and CMTS markets have become more concentrated despite the growth in market demand. In the fixed line market, the two largest carriers account for about three quarters of the market, leaving only a quarter of the market to 71 other carriers. In the CMTS, the two largest service providers control 96% of the market. In both markets, the market shares of competitors are too small to pose any significant threat on dominant providers.

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[1] Two alternative measures of competition reveal in Table 1 that the LEC and CMTS markets have become more concentrated despite the growth in market demand. The Herfindahl-Hirschman Index (HHI)[1] in the former increased from about 3,900 in 1999 to more than 4,200 in 2004, while in the latter, from about 4,000 to 4,900 during the same period. This index takes account of the relative size and distribution of firms. A score close to 0 implies intense competition among a relatively large number of firms, each having small and almost equal proportion of the market, while the maximum score of 10,000 corresponds to a monopoly. In the U.S., a market with HHI less than 1,000 is considered not concentrated; between 1,000 and 1,800, moderately concentrated; and more than 1,800, concentrated.

A simpler measure of concentration that however ignores the distribution of firms is an *n*-firm concentration ratio, which represents the sum of market shares of *n* largest firms. In the fixed line market, the two largest carriers account for about three quarters of the market, leaving only a quarter of the market to 71 other carriers. In the CMTS, the two largest service providers control 96% of the market.

Table 1. Measures of Market Competition in Fixed lines, Mobile and Internet Services

	1999	2004
Fixed lines service		
Number of operators	76	73
Subscribers base	2,892,435	3,437,491
Herfindahl-Hirschman Index	3,931	4,240
2-firm Concentration ratio	70.12	74.62
Cellular mobile telephone service		
Number of operators	5	4*
Subscribers base	2,849,880	32,935,875
Herfindahl-Hirschman Index	4,093	4,858
2-firm Concentration ratio	84.65	96.31
Internet services		
Number of operators	31	43
Subscribers base	350,000	1,200,000

*SMART and PILTEL are considered to belong to one group, *i.e.*, PLDT group.

In the internet service market, the absence of data on subscription base of service providers precludes a similar analysis of concentration. The Commission however is of the impression that the previously regarded competitive market, dominated by a teeming number of relatively small service providers, has also become concentrated and dominated by subsidiaries of large carriers. The Commission further is of the opinion that a few independent service providers remain viable but their market positions are threatened by their dependence on access to the infrastructure owned by the carriers.

But it is not only the competitors' weak command of the market that is a cause of concern. Equally disconcerting is the fact that most of the non-dominant service providers are in precarious financial condition. An indication of this can be gleaned from the comparative five-year financial performance of the largest two and next two largest carriers (by size of asset) in Table 2. Excerpted from the financial statements of carriers are the earnings before income tax and depreciation and amortization (EBITDA), net income and gross revenues. Revenues that would allow a carrier to cover the operating expenses and 15% of the cost of investment in information infrastructure are calculated and compared against actual revenues. The figures clearly show that while the largest two carriers are able to recoup at least 15% of their costs of investment in most years, the next two largest carriers are weighed down by perennial losses in their operations.

Financial data for the other carriers are scarce but one could reasonably expect the smaller carriers to be in no better shape than their counterparts with larger revenue base.

Table 2. Financial Performance of Major Carriers
(billion pesos)

	2000	2001	2002	2003	2004
Largest two carriers					
EBITDA	21.8	34.6	46.8	58.1	77.3
Net income	1.2	7.0	9.9	21.5	39.2
Actual gross revenue	80.7	115.9	126.0	147.2	181.9
Required gross revenue to recover 15% cost of money	93.0	112.3	110.2	118.7	148.5
Difference between actual and required gross revenues	-12.3	3.7	15.8	28.5	33.4
Next two largest carriers					
EBITDA	2.6	1.6	0.8	-4.2	
Net income	-3.2	-5.4	-5.6	-9.0	
Actual gross revenue	10.5	11.6	10.5	10.3	
Required gross revenue to recover 15% cost of money	15.1	15.9	15.8	17.7	
Difference between actual and required gross revenues	-4.6	-4.3	-5.4	-7.4	

Question 2: Do you support the assessment that the balance of market power in the industry is highly skewed? To what extent are the current financial difficulties of most carriers (except for a few large ones) affecting the state of market competition and future development of the industry?

Trend 2: The precarious financial condition of non-dominant licensees is less a consequence of the smallness of their subscribers' base than a product of unregulated price squeezing behavior of the dominant licensees.

A price squeeze occurs when a major vertically integrated supplier sells inputs to its downstream competitors at a price so high, relative to its own retail price, that they cannot be expected to compete profitably in the same retail market. It can occur when operators with market power control certain activities that are key inputs for competitors in downstream markets and where those same key inputs are used by such operators or their affiliates to compete in the same downstream market.

In the telecommunications market, for example, a dominant firm can deliberately effect a price squeeze on a smaller competitor under a setup where the price of an intermediate good (e.g. the access charge) is negotiated. The determination of access charge, in this example, creates a competitive risk especially to potential entrants if the incumbent raises access price and lowers the final product price (which its competitors must match if they are to compete), thereby putting a price squeeze on new entrants.

In the context of the Service Area Scheme (SAS), the issue of price squeezing is particularly relevant. Since the onset of competition in the Philippine telecommunications sector, non-dominant licensees have been remonstrating that unless the Commission acts upon the access charge imposed by the incumbent, the cross-subsidy business model of the SAS would not be tenable.

Note that the viability of segmenting the market and imposing service obligations on carriers under SAS was premised on the feasibility of using domestic and international toll revenues to subsidize fixed line services. And indeed, SAS was viable at the start of the local exchange rollout in 1996, when the accounting rate was as high as $1.20 and the incumbent's (PLDT) access charge was $0.35, thereby providing carriers with a margin of $0.25 per minute of international call to finance the rollout.

In subsequent years, however, the accounting rate declined with the advent of new technologies that made it easier to bypass the system. New carriers would have been able to adjust to the collapse of the accounting rate system were it not for the fact that the incumbent kept its access charges high. Specifically, the accounting rate has fallen faster than the incumbent's access charge, thereby squeezing the margins of the IGF operators.

The same trend was apparent in the IXC market where bypass technologies and mobile services are exerting downward pressure on national long distance rates. The unregulated access charge of the dominant licensee in the face of declining international and long distance rates deprived the smaller carriers of resources for roll-out and for posing effective competition against the incumbent.

In addition, the Commission's mandate on all carriers to provide indirect access to each other's network has also been rendered ineffective because the high access charge precludes one carrier from viably carrying another carrier's traffic.

In 2002, when the incumbent raised and pegged the access charges to US$0.12 for fixed line and US$0.16 for mobile services, it became doubly difficult for smaller IGF operators to remain viable amidst the continuous downward pressure on settlement rates. Consequently, one's IGF operation could only be as large as one's subscribers' base. This goes as well for the IXC business. Given the high concentration in fixed line and CMTS markets, competition in the international and domestic toll business is now limited to the few carriers with significantly numerous subscribers.

Question 3: Do you agree that unchecked vertical price squeezing behavior by dominant licensees has been mainly responsible for the financial woes of smaller carriers? How are smaller carriers coping with price squeeze? What market opportunities are still open smaller carriers if the price squeeze continues?

Trend 3: Horizontally integrated licensees are engaged in cross-subsidization to stem the churn out from fixed to mobile services, to the detriment of non-integrated licensees.

Fixed line service providers that are not licensed to provide mobile services are increasingly disadvantaged by their competitors with mobile service licenses. In recent months, the Commission has received numerous complaints of predatory pricing against certain carriers whom are perceived to be using revenues from their mobile services to support their market strategies in the fixed line market. At the heart of this issue is that the shift in consumer preference from fixed to mobile phone services which, by itself, has rendered it difficult to sustain the financial viability of wired services.

Yet the shift in preference was largely unanticipated at the time SAS was designed. Neither was it envisioned that the mobile service market would have evolved to become less competitive than the fixed line market.[2] Thus, while the SAS sanctions cross-subsidy of fixed services using revenues from mobile services, it was envisaged under a different market environment. To use revenues from one service market subject to less intense competition to cross-subsidize one's conduct in another service market subject to more intense competition does not constitute *per* se anti-competitive conduct. But, if a carrier

[2] The reverse is true in most economies, *i.e.*, fixed line market is less competitive than mobile service market as the entry barrier in the former is higher.

holds substantial power in one market and takes advantage of such power by cross-subsidizing its service offerings to hinder or substantially reduce competition in another market, then its conduct must be construed as improper.

Cross-subsidization inevitably puts downward pressure on prices of the subsidized market, thereby benefiting consumers. The benefits however may only be temporary if the long-term impact on competitors is to weaken them to such extent that they are unable to pose effective and sustainable competition, or worse, to induce their eventual exit in the market. Moreover, the resultant fierce price competition may not only prevent competitors from acquiring new customers. It may also curtail their infrastructure investments. If the latter happens, then the unfettered cross-subsidization of services could frustrate not only market competition, but also universal service.

Question 4: How accurate is the above description of cross-subsidization of services by integrated licensees? What indicators may be used to detect cross-subsidization? How can non-integrated licensees overcome their market disadvantage if vertically integrated licensees are permitted to continue cross-subsidizing their services?

Trend 4: Large carriers appear to be leveraging their control of the last mile into the unregulated value-added service market.

In recent years, the growing demand for internet and data services has enticed major carriers to engage in value-added services, particularly internet services. As shown in Table 3, the share of data services in the revenues of large carriers is still modest. But as the growth of wireline revenues tapers, while that of data services surge, large carriers can be expected to become more aggressive in their VAS undertakings.

Table 3. Revenues of Four Largest Carriers

	2000	2001	2002	2003	2004	Average annual growth %
(*Billion pesos*)						
Wireline	56.8	59.2	57.6	58.5	61.0	1.3
Wireless	31.6	55.6	75.2	110.6	130.3	42.3
Data* and internet	3.0	2.8	3.7	5.3	6.8	26.0
Total	91.4	117.7	136.5	174.4	198.2	21.5
Share (%)						
Wireline	62.2	50.3	42.2	33.6	30.8	
Wireless	34.6	47.3	55.1	63.4	65.8	
Data* and internet	3.2	2.4	2.7	3.1	3.4	

*Over wireline only.

In the past, the Commission has not been keen on monitoring the impact of large carriers' presence in the VAS market, not the least because this market has always been regarded competitive because of low entry barriers. However, the growing concentration of the VAS market, coupled with the increasing dominance of carrier-affiliated service providers that could be inferred from the exodus of small ISPs, has become a matter of interest for the Commission.

The concern of the Commission is whether the large carriers are using their control of the local loop to inhibit independent service providers from competing. It has been alleged that the wholesale price of access input (E1/R2 lines) that the incumbent carrier charges to independent ISPs bars the latter from competing effectively. This is because the margin between the retail price for VAS charged by the incumbent's affiliate and the incumbent's wholesale price for access input is too narrow to allow independent ISPs to remain viable (in other words, effecting a price squeeze as discussed previously).

Ascertaining the validity of the allegation requires the Commission to determine the reasonable costs of transforming the access input into retail service. In an ideal scenario, such costs combined with the wholesale price of access input should not exceed the retail price of the carrier's affiliate. Otherwise, the carrier can be deemed to have overpriced the access input and/or underprice its retail service, with the intent of hindering or reducing competition.[3]

Unfortunately, the Commission cannot make such an imputation without information on the "reasonable" costs of providing VAS, *i.e.*, the cost of a service provider that is "equally efficient" as the carrier's affiliate. Neither has the Commission enforced strict accounting separation on vertically integrated carriers so they may be required to supply information that would reveal if the affiliate would have covered its production costs if it had to buy access from its parent.

Whether due to the Commission's failure to respond to said charge against large carriers or a natural outcome of market competition (less efficient providers bowing out of the race), the fact is that only about 5 independent ISPs are believed to have the capacity to compete against carrier-based ISPs.

Question 5: Is there support for the view that large carriers have used their control of the last mile to favor their affiliates at the expense of independent ISPs? What evidence may be offered to boost this claim? What regulatory intervention is required to enable independent ISPs compete against carrier-affiliated ISPs?

[3] This is the imputation test used by the Australian Competition and Consumer Commission (ACCC) to detect vertical price squeeze.

III. Four Major Policies to Level the Playing Field

The apparent trends discussed in the preceding section point to the core of market competition problem in the industry – the hitherto unchecked behavior by some dominant carriers of leveraging the power that they hold in one market into another. This has resulted in various forms of abuses of market positions and unfair practices such as cross-subsidization, predatory pricing, and vertical price squeeze, among others. The lack of effective competition in one market has spilled over into another, thereby transforming markets such as VAS that used to be fertile ground for competition by small- and medium-sized service providers into a concentrated, carrier-dominated market.

Thus, all three submarkets in the industry can now be considered dominated by a few vertically and horizontally integrated service providers.

To address the current imbalance of market power, the Commission is contemplating the implementation of four major policies that have been used with success in other regulatory regimes to facilitate and promote effective and sustainable competition in the information and communications technology sector. Specifically, these policies constitute what the Commission is presently inclined to believe are necessary and deliberate steps to promote competition where it is currently ineffective or unsustainable, and to introduce competitive safeguards to protect non-dominant providers against the unreasonable exercise of market power by dominant providers.

Policy 1: Impose Significant Market Power (SMP) obligations

In other jurisdictions, the current Philippine situation as characterized by the trends discussed above would have clearly called for imposition of heavier regulatory obligation on service providers who occupy dominant positions, compared to those imposed on non-dominant providers.

The rationale for unequal treatment of dominant and non-dominant licensees is well accepted in many regulatory regimes. Singapore, Malaysia, Hong Kong, and EU are few examples of regimes that recognize the need for different regulatory treatment of dominant licensees to balance the distribution of market power, and thus make competition more effective and sustainable. It is considered judicious of regulator to distinguish between licensees whose conduct are not constrained adequately by competitive market forces (dominant service providers) and those that are subject to competitive market forces (non-dominant service providers). The former is made to comply with more stringent regulatory requirements, while the latter operate under minimum regulatory rules, but are nonetheless subject to ex post enforcement of competition rules.

Where competition has been rendered ineffective by the dominance of some licensees, regulators of Hong Kong, UK, Singapore and Malaysia, to name a few, consider it expedient to impose obligations on dominant licensees to provide competitive safeguards for non-dominant licensees.

In adopting this policy, two issues emerge:

(a) the determination of dominance or significant market power (SMP), and
(b) the specification of obligations on dominant licensees.

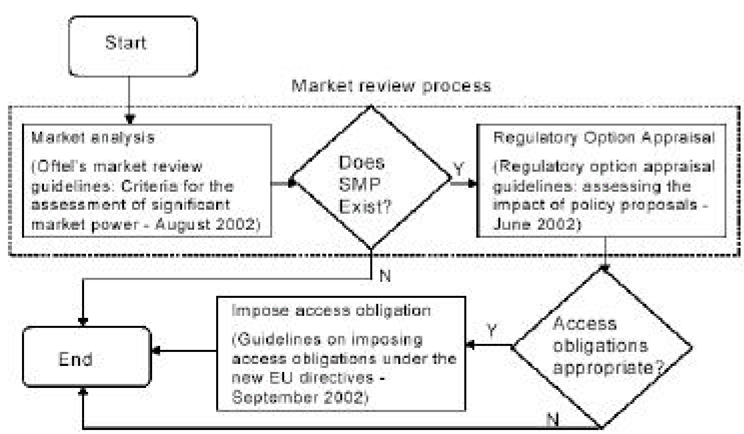
Determining Significant Market Power

There is broad agreement on the principles that can be applied to determine dominance or SMP (even though the actual implementation may vary in different regulatory regimes). Dominance is regarded as a position of economic strength that allows its holder to make market decisions appreciably independent of considerations for competitors and consumers. Simply put, a dominant licensee is not subject to competitive market forces.

To determine if a licensee stands impervious to market forces requires an incisive assessment of the market, taking account of both actual and potential competition. A host of criteria is therefore used to determine dominance, among them: market share, control of bottleneck infrastructure (that which is not easily duplicated but required for delivery of various services), technological superiority, consumer power, economies of scale and scope, and vertical integration.

Of these, market share is widely considered as the most transparent indicator of SMP. In the European Union, for example, a market share of 40% gives rise to a presumption, but not conclusion, of SMP. If such share is however declining or fluctuating over time, it is taken as indication of lack of SMP. On the other hand, a market share of less than 25% is deemed insufficient for a licensee to behave as if it were unaffected by market forces.[4]

[4] The graph below shows the relevance of determining SMP in terms of imposing access obligations under the new European Union directives.



A licensee's dominance is evaluated in reference to a specific product or service market, thus the definition of a market is also relevant. Defining a relevant market requires technical consideration of demand and supply conditions. However, in cases where a licensee is able to leverage the power it holds in one market into another (horizontal or vertical) market, then its dominant position is deemed to apply on both. That this is the case in the Philippines, as elaborated in the preceding section, tends to simplify the task of defining the scope of market dominance.

Specifying SMP Obligations

Perhaps a more contentious issue is specifying the obligations of dominant licensees. In Singapore, these obligations are stipulated in the Telecommunication Act. Among the "duties" ascribed to dominant licensees, in addition to those applicable to other licensees, are:[5]

- Duty to provide service at just and reasonable prices, terms and conditions
- Duty to provide service on a non-discriminatory basis
- Duty to provide unbundled telecommunication services
- Duty to provide service on reasonable request
- Duty to allow resale of end user telecommunication services
- Duty to allow sales agency to resell end user telecommunication services
- Duty to file tariffs with the regulator and to obtain approval prior to offering or modifying the terms of its offerings of certain services, among them end-user, resale and wholesale
- Duty to publish tariffs
- Duty to provide service consistent with effective tariffs
- Duty to develop a Reference Interconnection Offer (RIO)
- Duty to publish all interconnection agreements[6]

The additional burdens imposed on dominant licensees are designed not only to provide competitive safeguards to non-dominant licensees, but also to facilitate the entry of new service providers, specifically by allowing resale of services. Moreover, while the competition law implicitly requires all licensees (dominant and non-dominant) to offer services at "just and reasonable prices, terms and conditions", mandating this principle explicitly on dominant licensees recognizes the market leadership that that the latter assumes. Note that non-dominant competitors are cannot set prices, terms and conditions that are less attractive than those offered by dominant licensees. Compelling dominant licensees to make such a service offering is tantamount to requiring the whole industry to follow the same.

[5] Sections 4 and 6 of the Telecommunication Act (Chapter 323): Code of Practice for Competition in the Provision of Telecommunication Services 2005.
[6] At the request of either of the licensees, the IDA may withhold publication of any portion of an interconnection agreement "*if IDA determines* that it contains proprietary or commercially sensitive information" (Section 6.5 of Telecommunication Act, emphasis mine).

Perhaps the most significant obligation imposed on the dominant licensee by the Singaporean regulator (Info-communications Development Authority, IDA) is the development of RIO, the terms of which it has to approve. Non-dominant licensees have the option of obtaining interconnection-related and mandated wholesale services from the dominant licensee by accepting the RIO, or by negotiating an individualized interconnection agreement.

As a default mechanism, therefore, the RIO is a means of ensuring that the dominant licensee provides interconnection on non-discriminatory terms to its competitors. Since the terms of the RIO have to pass regulatory scrutiny, unfair terms and conditions of interconnection are avoided, thereby affording protection to non-dominant licensees who are often at the short end of the bargaining for interconnection.[7] Moreover, the availability of RIO cuts short the often long, tedious and costly interconnection negotiations.

Finally, obligating dominant licensees to publish access prices and interconnection agreements, combined with the regulator's exercise of its powers to approve prices of end-user, resale and wholesale services, will prevent the kind of anti-competitive behavior that large carriers are accused of.

Question 6: Do you agree that additional regulatory burdens should be placed on dominant licensees in order to ensure effective and sustainable competition in the ICT market? What criteria may be used to determine dominance? How should markets be defined for purposes of determining dominance? What obligations should be imposed on dominant licensees to be able to effectively counter-balance their market power? Do you think the idea of a Reference Interconnection Offer would be useful and relevant in the Philippine context?

[7] A standard RIO could contain the following:

- Description of the services and facilities to be provided, including their technical characteristics;
- Location of the points of interconnection and access and of other associated facilities;
- Technical standards for access and interconnection;
- Conditions for access to supplementary and advanced services (including support systems, information systems or databases for pre-ordering, provisioning, ordering, maintenance, and repair requests and billing);
- Ordering and provisioning procedures;
- Changes, terms of payment, and billing procedures;
- Traffic management;
- Maintenance and quality of interconnection and access services;
- Measures to ensure compliance with requirement of network integrity;
- Intellectual Property Rights (IPR);
- Dispute resolution procedure between parties before requesting national regulatory authority intervention;
- Duration and renegotiation of agreements;
- Rules for allocation between operators where supply is limited;
- Standard terms and conditions of supply.

Policy 2: Mandate unbundling of network elements

The Commission has considered mandating the unbundling of network elements since early 2000, as a policy tool for promoting competition. The issue of opening access to carriers' networks is even more relevant now, in light of the Commission's recent regulatory pronouncements regarding Voice over Internet Protocol (VoIP) which would allow VAS providers to offer VoIP. Without an unbundling mandate that would open access by VAS providers to carrier networks, there is a risk that the VoIP rules will only be rendered inutile.

In simplest terms, unbundling refers to the provision of network elements on a stand-alone basis. The owner (access provider) may offer its network "bundled" on a "take-it-or-leave-it" basis; or "unbundled," thereby allowing a service provider (access seeker) to choose only the specific network elements that it requires.

Network elements that could be unbundled include access lines (local loops and related functions), local switching functions, tandem switching function, inter-exchange transmission, access to signaling links and signal transfer points, access to call-related databases, central office codes, subscriber listings, operator services, directory assistance functions and operations support systems (OSS) functions. The most important of these elements is the local loop or so-called "last mile."

It should be noted that unbundling is among the regulatory principles enunciated in the WTO Reference Paper that suggests an incumbent should be made to provide interconnection to competitors on a sufficiently unbundled basis so the latter would avoid charges for components that they do not require for delivering their services.[8]

An unbundling policy is viewed pro-competitive because it would lower technical and economic barriers to entry by allowing a new operator to obtain some components of its network from the incumbent, while building the other components. It likewise promotes efficiency by avoiding the unnecessary duplication of investments. Deployment of new services is also encouraged since service providers can combine new technologies (*e.g.* ADSL and IP data/voice switches) with components of existing networks (*e.g.,* access lines).

However, compelling the incumbent to unbundle could dampen the incentive of new operators to invest in their own facilities. It is argued that the limited or non-availability of unbundled loops will compel entrants to invest in alternative network like fixed wireless or mobile. Moreover, if unbundled elements are priced below costs, it may also weaken the incumbent's incentive to enhance its own facilities. Thus, while an unbundling policy may promote competition for delivery of services in existing network

[8] The Philippines is among the 69 countries that have adopted the Reference Paper, although the Philippine Congress has yet to ratify the Fourth Protocol.

(service-based competition), it may however inhibit facility-based competition, which could stifle the development of the industry in the long-run.[9]

The tension between lowering entry barriers on the one hand, and undercutting incentives for infrastructure investment, on the other, has divided regulators on the virtue of mandating unbundling. In the OECD, for example, only 23 of its 30 member economies have introduced local loop unbundling (LLU).[10]

In practice, several versions of unbundling policy exist. Some countries, for example, mandate "transitional unbundling," *i.e.*, only for a limited period to "jumpstart" competition. In others, "selective unbundling" is implemented, *i.e.*, unbundling access to some network components but not all. Experiences of developed countries in unbundling now suggest that while unbundling policy is sound, it should be limited to essential (bottleneck) facilities so as not to distort incentive to invest in infrastructure.[11]

Local Loop Unbundling (LLU)

Local loop is an example of an essential facility. Where the incumbent remains dominant in the local loop, an unbundling policy is considered imperative in introducing effective competition. That is the case in Singapore where the incumbent Singtel still controls nearly 100% of fixed lines even after the market has been fully opened to entry.

The Singapore regulator requires Singtel to offer unbundled network elements (UNE) and unbundled network services (UNS) as part of its dominant licensee's obligation. Four network elements have been identified for mandatory offering: (i) local loops, including feeder, distribution, distribution point and inside wiring; (ii) sub-loops and associated distribution points; (iii) line sharing or loop spectrum which allows an interconnecting operator to deploy DSL services over Singtel's network; and (iv) distribution frame access to allow interconnecting operator to cross-connect the loop to its equipment. However, only two services have been stipulated for UNS, namely, provision of access to emergency services call centers, and the addition of local telephone location data to the emergency services database.

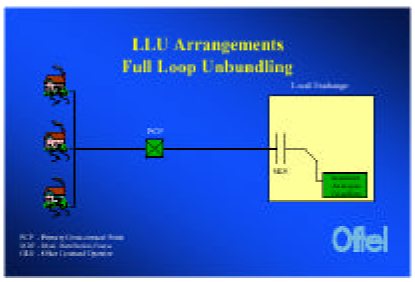
In Korea, LLU policy is credited not only with promoting competition in the local access market, but also for accelerating the roll out of broadband services, including internet, e-commerce, video and other data services. Indeed, competitive provisioning of broadband services is feasible only with open access to the local loop.

[9] As a policy goal, facility-based competition is considered superior to service-based competition since the former is believed to create more demand, stimulate more innovation and maximize efficiency compared than the latter.
[10] As of end of April 2002 (Malaysian Communications and Multimedia Commission, 2003).
[11] The rationale for this suggestion is the following: not only is it uneconomical for every service provider to duplicate such type of facility or infrastructure (because of strong scale economies), but the owner of an essential facility has also the opportunity to monopolize complementary or downstream segments. The unbundling policy is designed to counter-balance the power of the essential facility owner.

Local loop can be unbundled in several ways depending on the depth of access that the network owner is willing or mandated to provide. Four broad types of LLU are described as follows:

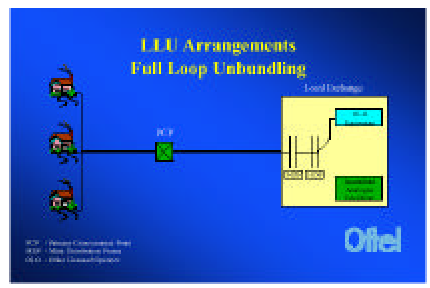
- Full unbundling gives the interconnecting party full access and control over the local loop, *i.e.*, access to copper bcal loops terminating at the local switch and sub-loops terminating at the remote concentrator or equivalent facility. In this form of unbundling, the link between the main distribution frame and the local switching equipment on the access provider's premises is re-routed and connected to the interconnecting operator's switch.

WE CAN PLACE GRAPHS LIKE THESE BELOW TO ILLUSTRATE THE LOCAL LOOP UNBUNDLING



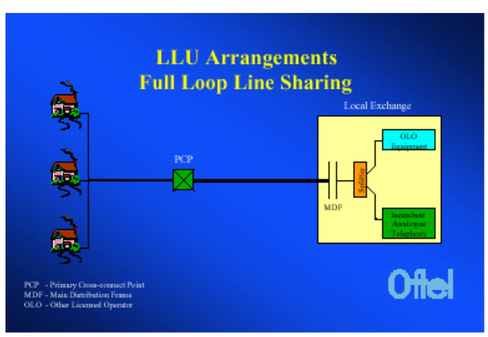
Before Full-Unbundling

Local Loop Unbundling Factsheet, OFTEL



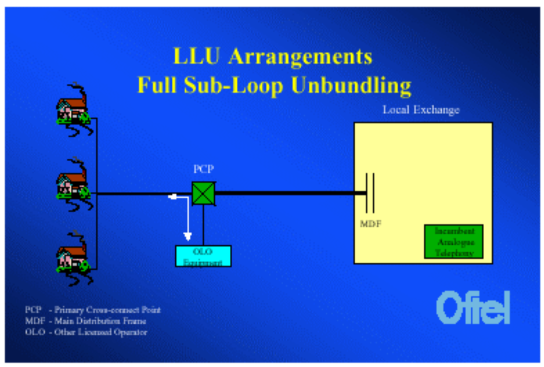
After Full-Unbundling

- Line sharing involves the shared use of the copper loop. This form opens the access only to the high-frequency spectrum of the local loop. Nonetheless, it permits competitive provision of Digital Subscriber Loop (DSL) systems and services. The access provider and interconnecting operator can provide services over the same loop. For example, a customer can retain the former as its telephone service provider and at the same time, select the latter to provide high-speed internet service over the same loop.



- Bitstreaming limits the access to high-speed bit stream. The network owner would have to install a high-speed access link to the customers' premises and make it available to the other operators to enable them to provide high-speed services. Technically, bitstream access can be provided to any transmission system since it only requires reservation of a specified bandwidth instead of dedicated use of a physical loop. Thus, this form of unbundling does not require the access provider to provide physical access to its loop and therefore it is able to retain control over its network.

- Access to sub loop provides the interconnecting party access to the network in between the main distribution frame and the customer premises equipment. This type of access is required for very high bandwidth services that can only be transmitted in short distance on the copper cable. Because the technical issues for establishing sub loop access are too complex to regulate, only a few regulators (such as the EU) have implemented this type of unbundling.



The effectiveness of local loop unbundling in promoting competition depends largely on the manner of its implementation. The regulator may require full unbundling, or it may simply mandate loop access without specifying the type of access arrangement. If unspecified, a network owner will likely limit the access to high-speed bit stream, as what local carriers are offering VAS providers.

The Commission notes, however, that even with bitstreaming type of unbundling, a network owner could delay the installation of high-speed access link until it is able to provide high-speed access services. Independent ISPs have complained to the Commission in the past about the delays by one carrier in installing high-speed access link, purportedly to give time to its ISP subsidiary to establish its base in the market. Whether this is true or not, the Commission is inclined to believe that a policy that does not specify the form of local loop unbundling required on incumbent would have limited value.[12]

[12] In Malaysia, the absence of a clear-cut mandate on the incumbent Telekom Malaysia to unbundle its local lines allows its subsidiary, TMNet, to control 70 percent of the internet service market.

Apart from specifying the network elements to be unbundled, a policy on mandatory unbundling has to contend with two other issues: collocation arrangements and pricing of unbundled network elements and collocation space. These issues are not covered in this Consultation Document. The Commission intends to flesh out their details in a separate document on interconnection as part of the second phase of this initiative, sometime in the first quarter of 2006.

Question 7: Will a policy of mandatory network unbundling improve the balance of market power in interconnection negotiations? Which network elements should be unbundled? What type of local loop unbundling should be mandated? How can the regulator enforce network unbundling effectively?

Policy 3: Allow for resale of services

The opportunity to resell services that would have been otherwise offered by carriers arises when the latter are required to offer them at wholesale or discounted rates to competitors who can then sell them to their own customers. Clearly, such opportunity will arise only if the regulator requires carriers to make their services available for resale.

The market benefits of allowing resale has been demonstrated in a number of other countries, including the United States. For one, it facilitates entry of new service providers that may initially lack the capital to build their own networks. Resale allows them to engage in arbitrage, *i.e.*, purchasing a large volume of minutes or calls at a quantity discount and reselling them to small customers at prices lower than the retail prices offered by established carriers. Alternatively, resellers may obtain some services from established carriers and combine them with their own. Ultimately, the result is a downward pressure would be exerted on market prices, while consumers are feted to a wider array of service offerings.

Resale has also been found to spur the usage of existing networks. This is a consequence of demand created by new service providers who would have to be innovative in bundling services in order to attract customers. Thus, given the huge excess capacity on their networks, non-dominant carriers that are finding it difficult to expand their subscribers' base could find in resale an opportunity to recoup sunk investments incurred in their network roll-out.

Question 8: Will creating an opportunity for resale make the markets more competitive? Should the obligation to create an opportunity for resale be applied only to dominant licensees? What market benefits can be expected to accrue to non-dominant licensees if they allow for resale of their services? How much margin between the wholesale and retail prices of services is necessary for resale to be viable?

Policy 4: Enforce *ex post* regulation of prices

The Commission is also considering the streamlining of its current pricing regulatory framework by limiting *ex ante* regulation to dominant licensees and subjecting all others to *ex post* regulation. *Ex ante* regulation refers to the current policy of requiring licensees to seek regulator's approval before launching any tariff, discount or similar price promotion. In contrast, *ex post* regulation refers to the determination of whether a tariff or other pricing strategy constitutes anti-competitive conduct and therefore must be sanctioned, only after such tariff or strategy has been adopted.

Under such a pricing regulatory framework, only dominant licensees would be required to seek *prior* approval from the regulator for any discount or price promotion; other licensees engaging in similar price adjustment would only have to provide the Commission with advance notification.

The above notwithstanding, the Commission may initiate an enforcement action against any licensee, either on its own motion or at the request of a private party, if it finds reason to suspect that the price conduct of the licensee has an adverse impact on competition. In such a case, the Commission will notify the licensee and conduct an investigation. If the licensee continues with its conduct, then it must then bear the risk of penalties that would be imposed should the investigation validate the initial findings of the Commission.

This shift in pricing paradigm is consistent with the proportionality principle, articulated by the European Commission and adhered to in advanced regulatory regimes. This principle calls for policy measures that are "proportionate" to the objectives. Applied to pricing regulation, if the intent is primarily to curb abuse of market power, then accordingly, the regulation should focus on the licensee who has capacity to commit the abuse.

Moreover, *ex ante* regulation should only be imposed on a licensee whose actions are not restrained by competitive forces and where *ex post* remedies are not sufficient to reverse the impact of the conduct on market competition. In the case of a non-dominant licensee, although its conduct may have the effect of inhibiting or restricting competition, the fact that it is non-dominant suggests that it has neither the market scale nor deep pockets to affect market competition to a degree that cannot be corrected or reversed by the retrospective application of regulation. Proportionality also implies that *ex ante* pricing regulation may be completely withdrawn if a given market is deemed sufficiently competitive.

In applying competition principles in pricing regulation, two issues have to be addressed by the Commission:

(a) the appropriate competition test to apply, and
(b) the standard of proof question.

On the former, the inquiry is what conduct may be considered to have the "purpose or effect of preventing or substantially restricting competition," and therefore should trigger regulatory action.[13] Some types of conduct, such as price fixing, fall ostensibly under such a classification, but others are less easy to discern.

The other issue deals with question of standard of proof. In Hong Kong, the Office of Telecommunications Authority (OFTA) has adopted the civil standard of proof, *i.e.*, the regulator decides on the "balance of probabilities." Having decided that given the available evidence, the conduct of the licensee is more likely than not to constitute anti-competitive behavior, the action against the licensee is initiated. If the licensee could offer evidence to the contrary, the regulator will consider the claim and verify it to the extent possible. The regulator is however not required to offer a counter-proof to the claim if it decides to reject it.

Question 9: Is the paradigm shift in pricing regulation as described above tenable in the Philippine context? Which services should still be subject to *ex ante* price regulation? How can *ex post* price regulation be effectively enforced? Is a standard of proof similar to that applied in Hong Kong appropriate in the Philippine setting? Are there any other standards that might better apply?

[13] This phrase is commonly used by different jurisdictions in defining anti-competitive practice, see for example, Section 7K of the Telecommunications Ordinance of Hong Kong.

IV. Four Regulatory Handicaps of the Commission

The difficulty of the Commission to offer immediate and effective response to developments that are ostensibly threatening competition, such as those noted section I, can be traced to a number of handicaps. At least four of these constraints stand out, namely: resources, legacy of past lapses, regulatory powers and information.

In discussing these issues, it is not the intent of the Commission to absolve itself from its past remissions or present responsibilities. Rather, it is to put in perspective a plan of action (outlined in the next section) to address them.

Handicap 1: The Commission lacks resources to govern effectively and achieve its mandated goals.

Regulatory oversight over the telecommunications industry requires possession of considerable number of professional staff, modern equipment, fairly adequate information database and political independence – all of which the Commission lacks or has insufficient and inadequate numbers. The Commission needs greater technical expertise to manage spectrum efficiently, to monitor the service quality being provided by licensees, to enforce technical standards, and to discern when any diminution in competition is in fact a consequence of improper conduct by any licensee.

It may be argued that budget limitation is inherent of government institutions in a developing country. But elsewhere, regulatory agencies have managed to resolve the funding problem (as well as the associated issue of political independence) by resorting to a variety of funding mechanisms, *e.g.,* licenses, spectrum fees, regulatory taxes, and fees for allocating numbering resources.

The Commission however is constrained to a single source of funding, *i.e.,* government appropriation. None of the supervision and license fees that it collects is retained in the agency. And while the Commission's collection of fees has increased 12-fold over the decade since 1992, its budget has only doubled in the same period. Given that the complexity of regulatory issues grows proportionately with the size of the industry, the growing disparity between the demands on the Commission and its capacity to respond can no longer be ignored.

Handicap 2: Past regulatory lapses and policy flaws are undermining the credibility and effectiveness of the Commission as regulator.

In the past, the Commission has taken a mediatory stance on most issues brought to its attention. Some stakeholders have viewed such response as inadequate from a regulator whom they expect to check against abuses of market power. The Commission's forbearance on infractions of some licensees has also worked against its credibility as regulator. For example, when the Service Area Scheme (SAS) participants defaulted in their obligations, the Commission had the recourse of revoking their provisional authority to operate, but it did not. It does not help that some of the policies that the Commission is made to enforce are problematic, such as the SAS.

The legacy of these lapses in regulation is the erosion of confidence in the Commission's capacity to resolve disputes and correct market failures. The Commission recognizes that a number of stakeholders may become reluctant (if they are not already so) to bring matters to the Commission if they cannot expect to obtain just relief. This state of affairs has permitted patent exercises of market power to remain unsanctioned, distorted market incentives and encouraged collusion.

Handicap 3: Limits to the constitutional and statutory powers of the Commission exist and are significant.

Three pieces of legal and regulatory issuances rightly deemed competition as the most efficient mechanism for providing incentives for firms to expand their networks, introduce new technologies and services, and embark on new business ventures, to benefit both their own as well as the consuming public's interests:

?? Executive Order 59, issued in 1993, which mandated the compulsory interconnection of authorized public telecommunications carriers in order to create a universally accessible and fully integrated nationwide telecommunications network;

?? Executive Order 109, issued a few months after the implementation of Executive Order 59, which required all cellular mobile telecommunications services (CMTS) operators to install at least 400,000 telephone lines within three years, and international gateway facility (IGF) operators to put up 300,000 lines within five years; and

?? The Public Telecommunications Policy Act of the Philippines (RA 7925) which complemented Executive Orders 59 and 109, and laid down the foundation for the administration, conduct, and direction of the telecommunications industry.

At the heart of these issuances, and the resultant and undeniable success, was a conscious policy choice to promote competition, institutionalized through RA 7925 which provided that:

> ***A healthy competitive environment*** *shall be fostered, one in which telecommunications carriers are free to make business decisions and to interact with one another in providing telecommunications services,* ***with the end in view of encouraging their financial viability while maintaining affordable rates.*** *(RA 7925, Art. II, sec. 4(f).*

Ironically, the very same legal instruments, including the Constitution, which provided the critical spark to the liberalization and fostering of competition in the Philippine telecommunications market now appear to limit, if not hamper the continued development of, and increased competition in the ICT sector. The commercialization of new technologies, particularly those built around data and internet protocol technologies, are delayed if not actually proscribed, by unclear or technology-specific rules, often frustrating government's desires to further promote competition.

<u>The Constitution</u>

In the context of competition policy, there are two points worthy of note in the Constitution.

First, the Constitution explicitly deals with and espouses competition in its provision on monopolies and combinations in restraint of trade under Section 19 of Article XII (National Economy and Patrimony) which states that

> *(t)he State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed.*

Similarly, Art 16 (General Provisions) Section 11 provides that

> *Congress shall regulate or prohibit monopolies in commercial mass media when the public interest so requires. No combinations in restraint of trade or unfair competition therein shall be allowed.*

The Constitution, in other words, does not prohibit monopolies per se, but rather specifies a public interest test for regulating monopolies. Moreover, the Constitution makes a specific declaration that unfair competition shall not be allowed, presumably by firms with monopoly or market power.

The second point that should be noted, and which was likely unforeseen by the crafters of the Constitution as regards its now evident impact on competition in the ICT sector, relates to the Constitutional provisions on the ownership of public utilities and mass media.

Article 12, sec. 11 of the Constitution provides that

> *No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty per centum (60%) of whose capital is owned by such citizens…*
>
> x x x

The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines.

On the other hand, Art. XVI, sec. 11 provides that

The ownership and management of mass media shall be limited to citizens of the Philippines, or to corporations, cooperatives or associations, wholly-owned and managed by such citizens.

These provisions reflect the traditional legal provisions that regulate different ICT-related industries (i.e., telecommunications, cable, broadcast, value-added service, mass media companies, and arguably even power) separately and differently.

Technology, however, has not been limited by such artificial separations, and has now blurred the differences between those industries. It is now technically, if not legally, possible for players from these various industries to compete among and between each other. Telecommunications companies could, for example, provide mass media services and content, just as cable companies can now easily provide internet-related services, including voice over IP telephony.

These possibilities bring with them new challenges to the Commission; and the ownership limitations prescribed by the Constitution effectively limit, or at least cloud the business and investment possibilities that are now possible in this era of convergence. Suffice it to say,for now, that while there is a consensus between government and market players that full-blown competition between ICT players is, in principle, a desirable outcome, competition in the Philippines must flower – for better or worse – under such limitations as effectively mandated by the Constitution and related laws that reflect similar constraints.

<u>Statutory Overview of Competition-Related Statutes and the ICT Sector</u>

The principal statute governing the regulation of telecommunications providers, RA 7925, contains several pertinent declarations related to the interplay between market conduct of regulated firms, national policy and optimal regulations.

Article II, Section 4 paragraph (f) of RA 7925 declares as a matter of national policy that competition shall be fostered and in such a way as allow carriers to make economic decisions that will assure both their financial viability and rates that are affordable to end users. Thus, it states that:

...a healthy competitive environment shall be fostered, one in which telecommunications carriers are free to make business decisions and to interact with one another in providing telecommunications services, with

the end in view of encouraging their financial viability while maintaining affordable rates...

R.A. 7925 also mandated the privatization of government-owned and operated telecommunications facilities, while deregulating rate and tariff fixing, and removing the 12 percent cap on rate of return.

Value-added services (VAS)[14] providers are not regulated and needs only to register with the Commission, provided that they do not set up their own networks and rely solely on the transmission, switching and local facilities of enfranchised telephone companies.

In terms of determining end-user prices, traditionally, the industry adhered to a return on rate base (RORB) regulation, which set the maximum allowable return of 12% based on the net book value of property, plant and equipment plus working capital covering two months average operating expenses. RA 7925 eliminated the 12% ceiling but provided no basis for the determination of "fair and reasonable" rates. The industry has been pushing for rate rebalancing and metering. In the absence of a set of principles and concrete guidelines for rate setting, the resolution of these issues remains contentious.

By far, the most critical competition issue that has emerged from the liberalization of telecommunications is interconnection, which is required to enable subscribers of different carriers to communicate with one another or enjoy the services of other carriers.

Interconnection issues can also be expected to arise once VoIP is deregulated and VAS providers start offering the same to the public for compensation.

RA 7925 and its Implementing Rules and Regulations provide some guidelines but these have proven to be inadequate in resolving interconnection issues. The price of interconnection, which can take the form of an access charge or a share of the revenues, is not regulated. Instead, the determination of interconnection and access tariffs are left to negotiations between concerned parties. Being bilateral in nature, settlement of the terms of interconnection is determined by the relative bargaining strengths of the carriers. Access payments usually make up a significant portion of the operating costs of a new entrant (e.g., 30-40%) while it is a source of revenues for incumbents particularly in the beginning when the direction of calls is from subscribers of the new carriers to the subscribers of incumbents.

Congressional intent in leaving negotiations to the parties was probably driven in large part by its recognition of the Commission's above stated difficulty in attracting and keeping qualified personnel with varied managerial, financial, and technical expertise due to low civil service compensation. The lack of clear policy on access charges and

[14] These refer to enhanced services beyond those ordinarily provided for by local exchange operators, inter-exchange operators, and overseas carriers, including internet services.

interconnection, nonetheless, can unfairly expose new entrants to strategic behavior (e.g. price squeezing) by incumbents.

For its part, the NTC now confronts the increasingly urgent need to formulate a framework that will guide it in resolving these issues and responding to the inevitable new ones that will arise in the future. Regulatory clarity – to the extent that it is possible – coupled with honest empowerment and capacity building that will allow the NTC to freely and effectively promote and/or manage competition in the sector is a prerequisite to the full growth and development of the ICT sector in the Philippines.

Handicap 4: The Commission lacks pertinent information on the operations of the regulatees.

All regulators contend with the fact that they have to depend mostly on information supplied to them by parties whom they regulate. Information asymmetry between a regulator and regulatee, *i.e.*, the former knowing less than the latter, is universal that not even progressive regulators have found ways to overcome.

The Commission however faces a severe information constraint in part due to its own neglect or failure to adequate exercise its regulatory powers to consistently and universally compel licensees to comply with reportorial obligations. Consequently, it does not have a database nor a system of information gathering that would allow it to more thoroughly analyze trends and make informed market intervention when necessary.

Question 10: Are there other constraints or handicaps that limit the ability of the Commission to regulate effectively? How can the Commission overcome these constraints?

V. Four Urgent Tasks of the Commission

Faced with the foregoing constraints, the Commission realizes the need for internal reforms to effectively implement the major competition policies outlined in Section II and to strengthen its institutional capacity to govern. Thus, simultaneous with the Commission's efforts to set the above stated policies in place, it also intends to begin undertaking the following measures:

Task 1: Assume a proactive regulatory stance on competition-related issues.

The Commission, in the exercise of its regulatory functions, must often balance, and sometimes even choose between, various public goals, including:

- ?? Achieving universal service by making affordable ICT services available to all citizens;
- ?? Ensuring that consumers have access to modern products and services that are of high quality, and corollarily are protected from fly-by-night providers; and
- ?? Elimination of the ability of any firm to exercise undue market power;

In the past, the Commission has largely exercised forebearance on issues of competition, choosing to leave the settlement of issues to the parties, where possible, and being involved only when called upon to do so by formal petition or complaint by any party.

In the context of the discussions above, and consistent with its statutory mandate as the "principal administrator" of R.A. 7925 and as such "to take the necessary measures to implement the policies and objectives" of the said law, including in particular the fostering of a "healthy competitive environment" and "full universal service," the Commission is now of the mind, and shall henceforth assume a proactive regulatory stance on competition related issues.

The issuance of this consultative document is, therefore, both a sincere effort by the Commission to involve all stakeholders in this ongoing process, and a first clear signal from the Commission of its desire to be more involved and deliberate in its efforts to promote competition in the ICT sector.

Task 2: Enforce strict reporting requirements on regulatees.

Further, the Commission shall more strictly monitor compliance with all required submission of reports and agreements from licensees. The Commission commits to be more diligent in ensuring licensees' compliance to their reportorial obligation, particularly those by dominant licensees. The Commission shall henceforth stipulate and enforce administrative sanctions for non-compliance.

Task 3: Strive to restore regulatees' confidence in the Commission.

The Commission is considering several measures to win back the confidence of stakeholders on the regulatory institution. The first shall be to exercise its statutory and administrative powers (including the imposition of appropriate sanctions and penalties) in order to credibly enforce policies. Another is to set time limits in resolving cases brought to the Commission.

The Commission shall continue to improve transparency of its regulatory conduct by publishing important decisions, regulations, consultations with stakeholders and other pertinent documents on the web. The Commission shall also continue to improve its mechanisms for soliciting and responding to public feedback and complaints.

Task 4: Work with the legislature to introduce changes in the regulatory structure.

In the forthcoming months, the Commission will exert maximum effort for the legislative body to consider its proposed law that aims to strengthen the regulatory capacity of the Commission. The NTC bill has sought, among others, fixed term of office for the Commissioners to shield them from political intervention, financial autonomy, and strengthening of quasi-judicial power. The Commission will also seek means to provide financial incentives to its personnel while improving the quality of its plantilla.

Question 11: Will the four measures enumerated above help the Commission improve its governance? What other measures should the Commission undertake to become more effective as a regulator?

VI. Conclusion

This Consultative Document lays down the major competition issues confronting the Philippine telecommunications industry. It should be clear that the major competition policies as well as the internal reforms that the Commission intends to pursue have a single objective, that is, to ensure that the market forces will eventually be allowed to perform the tasks of disciplining suppliers and delivering maximum benefits to consumers.

In this transition to competition, the Commission believes, and now seeks build broad stakeholder support behind such belief, that it must assume a more prominent and active role in leveling the playing field, and preparing the grounds for future market deregulation.

Below, to repeat, is a summary of the questions for which the Commission seeks input and comments from all ICT sector stakeholders:

1. Do you agree that the effectiveness and sustainability of market competition should be the overarching goal of the Commission? Is there other higher goal that should guide the Commission's undertaking?

2. Do you support the assessment that the balance of market power in the industry is highly skewed? To what extent are the current financial difficulties of most carriers (except for a few large ones) affecting the state of market competition and future development of the industry?

3. Do you agree that unchecked vertical price squeezing behavior by dominant licensees has been mainly responsible for the financial woes of smaller carriers? How are smaller carriers coping with price squeeze? What market opportunities are still open smaller carriers if the price squeeze continues?

4. How accurate is this document's description of cross-subsidization of services by integrated licensees? What indicators may be used to detect cross-subsidization? How can non-integrated licensees overcome their market disadvantage if vertically integrated licensees are permitted to continue cross-subsidizing their services?

5. Is there support for the view that large carriers have used their control of the last mile to favor their affiliates at the expense of independent ISPs? What evidence may be offered to boost this claim? What regulatory intervention is required to enable independent ISPs compete against carrier-affiliated ISPs?

6. Do you agree that additional regulatory burdens should be placed on dominant licensees in order to ensure effective and sustainable competition in the ICT market? What criteria may be used to determine dominance? How should markets be defined for purposes of determining dominance? What obligations

should be imposed on dominant licensees to be able to effectively counter-balance their market power?

7. Will a policy of mandatory network unbundling improve the balance of market power in interconnection negotiations? Which network elements should be unbundled? What type of local loop unbundling should be mandated? How can the regulator enforce network unbundling effectively?

8. Will creating an opportunity for resale make the markets more competitive? Should the obligation to create an opportunity for resale be applied only to dominant licensees? What market benefits can be expected to accrue to non-dominant licensees if they allow for resale of their services? How much margin between the wholesale and retail prices of services is necessary for resale to be viable?

9. Is the paradigm shift in pricing regulation (limiting *ex ante* regulation to dominant licensees and subjecting all others to *ex post* regulation) tenable in the Philippine context? Which services should still be subject to *ex ante* price regulation? How can *ex post* price regulation be effectively enforced? Is a standard of proof similar to that applied in Hong Kong appropriate in the Philippine setting? Are there any other standards that might better apply?

10. Are there other constraints or handicaps that limit the ability of the Commission to regulate effectively? How can the Commission overcome these constraints?

11. Will the four measures discussed above(taking a proactive regulatory stance, enforcing strict reporting requirements, restoring confidence in the Commission, and legislative reform) help the Commission improve its governance? What other measures should the Commission undertake to become more effective as a regulator?

Comments on this present initiative to develop a competition policy framework for the ICT sector need not be limited to the topics or questions enumerated above, and all interested parties are invited and encourage to submit any other view or comment they feel is relevant and/or useful to this effort.

In sum, the Commission trusts that this Consultative Document will lead to a common understanding of the state of, and steps necessary to promote competition in the ICT sector; and that it will encourage the participation and support of stakeholders for the Commission's initiative, ultimately resulting in rules, policies and actions that benefit both industry and consumers alike.

December 16, 2005

(Signed)
RONALD OLIVAR SOLIS
Commissioner

(Signed) JORGE V. SARMIENTO Deputy Commissioner	(Signed) JAIME M. FORTES, JR. Deputy Commissioner