

TELECOM DRAFT SEPARATION UNDERTAKING

Submission by
Orcon Internet Limited
and
Kordia Group Limited

23 November 2007

A. INTRODUCTION

1. Introduction

1.1 Kordia and Orcon thank the Ministry of Economic Development for the Opportunity to make this submission. This document is a joint response by Kordia and Orcon to Telecom's Draft Separation Undertaking to comply with the Minister's (Operational Separation) Determination.

1.2 The impact of operational separation has the potential to greatly improve competition in New Zealand's Telecommunications market. While we welcome the Determination, Orcon and Kordia submit that Telecom's Undertakings do not deliver the outcomes for competition that were addressed by the Minister's Determination.

2. Contacts

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3. **Summary**

- 3.1 Kordia and Orcon submit that Telecom's Draft Undertakings depart from the Minister's Determination, and do not achieve the purpose of Part 2 of the Act. Telecom has made a number of changes to specific requirements which narrow the focus of the Undertakings from the broader focus of the Act and the Minister's Determination.
- 3.2 In overseas markets the uptake of LLU has been frustrated by the vertical integration of the incumbent operator. Kordia and Orcon welcome operational separation to accelerate the uptake of LLU and help New Zealand catch up with the rest of the OECD for Broadband performance.
- 3.3 The Draft Operational Separation Undertakings at present have a long implementation period. To ensure New Zealand efficiently achieves the benefits of operational separation and Equivalence the Ministry must ensure that EOI is delivered as soon as possible during this implementation period.
- 3.4 These submissions focus on areas where the undertakings should be amended to more effectively achieving the purpose of the Determination and Part 2 of the Act.

"to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers."

B. SUBMISSION

4. *Compliance with Act and Minister's Determination*

- 4.1 Under Part 2A of the Telecommunications Act 2001 (*Act*), the draft separation plan must comply with that part of the Act and the Telecommunications (Operational Separation) Determination 2007.
- 4.2 The principal focus of these submissions is highlighting where we do not consider the Undertakings adequately comply with the Determination.
- 4.3 Telecom has weakened the requirements of the Determination with qualifying terms such as "reasonable" and "best endeavours." This significantly reduces the strength of the absolute nature of the Determination. Kordia and Orcon submit the Ministry should recommend that qualifying terms be removed from Telecom's Draft Undertakings where they are not consistent with the Act or the Determination.
- 4.4 Telecom has also changed a number of definitions in their Draft Undertakings from those defined in the Act and Determination. For example; the definition of *Telecom Fixed Network Business Units* is defined in the Determination as "any Telecom unit that provides functions in relation to Telecom's fixed network," whereas in the Draft Undertakings it is defined as "any business unit that controls fixed network assets predominantly used for the provision of Relevant Services", and they specifically exclude Telecom's Retail units. Kordia and Orcon are concerned that any change to terms defined in the Determination could result in unforeseen and damaging consequences.

4.5 In Telecom's Draft Undertakings the definition of *Employees* specifically excludes the CEO. While occasionally exceptions will apply to the role of the CEO, these exceptions should be made to individual terms in the Undertakings, rather than an overarching general exception.

5. ***Requirement to provide services limited***

5.1 In clause 6.2 of the Undertakings, the word *or* needs to be added to the end of each of sub-clauses (a) and (b).

6. ***Meaning of Equivalence of Inputs or EOI***

6.1 At clause 1.2(a)(v) of the Undertakings Telecom has removed the inclusive additional clause 9(1)(b) of the Determination and has instead included reference to the use by Telecom of systems and processes that Access Seekers are able to use in the same way and with the same degree of reliability and performance as part of the specific clauses related to Telecom's compliance obligations in respect of supply of Relevant Services to Access Seekers.

6.2 Although clause 1.2(a)(iii) of the Undertaking also obliges Telecom to deliver Relevant Services by means of the same systems and processes, the inclusive clause 9(1)(b) of the Determination allows for a wider interpretation of the meaning of EOI than is possible under Telecom's amended clause.

6.3 We submit that the removal of the inclusive clause is inappropriate and it should be re-inserted.

7. ***Arm's length rules***

7.1 The Determination provides that the Separation Undertakings have to provide that Telecom operate each of the ANS Unit,

the Wholesale Unit and the Retail Unit on an arm's length basis (see clauses 28, 53 and 73 of the Determination).

7.2 We consider that the arm's length rules provided in the Undertakings are drafted in a manner that is narrower than is provided for in the Determination for the following reasons:

7.2.1 Each of clauses 28(4), 57(4) and 73(4) of the Determination provide that the ordinary meaning of the expression *arm's length* is not limited by the relevant clause.

7.2.2 However, clauses 24.1, 52.1 and 69.1 of the Undertakings all provide that the relevant units will only operate at arm's length "in accordance with the requirements of these Undertakings". There are no equivalent provisions indicating that the ordinary meaning of the expression of arm's length is not limited by the Undertakings.

7.2.3 Whereas sub-clause (2) of each of clauses 28, 57 and 73 of the Determination are inclusive and provide an indication of what acting at arm's length includes each of clauses 24.2, 52.2 and 69.2 of the Undertaking are not expressed to be inclusive and therefore arguably limit what constitutes arm's length under the Undertaking.

7.3 We recommend that the clauses need to be inclusive, and the same recognition that the clauses do not limit the ordinary meaning of the expression *arm's length* be included in the Undertaking.

8. **Implementation**

- 8.1 Clauses 37, 38, 63 and 64 of the Determination (and clauses 33, 34, 58 and 59 of the Undertaking) respectively provide that Telecom must have policies in place for governing customer confidential information and commercial information.
- 8.2 Clause 4(3) of the Determination provides that the relevant clauses must bind Telecom to comply from the Separation Day, unless sub-clause (4) of clause 4 applies.
- 8.3 Clause 4(4) refers to other reasonable transition provisions that are included in the Undertaking and related to specific issues that:
- Are identified in the Undertakings; and
 - Reasonably justify a different transitional regime in respect of those issues.
- 8.4 Under clause 9.3(c) of the Undertakings, Telecom provides that to the extent clause 95 of the Undertakings requires arrangements with agents and contractors to ensure that commercial information, customer confidential information and commercial policy are dealt with in a manner that complies with the Undertakings, Telecom will use best endeavours to have those arrangements in place as soon as possible, but by no later than 31 December 2008.
- 8.5 We are concerned that this issue does not justify such a different transitional regime.
- 8.6 We query the extent to which changes to Telecom's outsourcing arrangements are beyond Telecom's control.

8.7 While clause 95 of the Undertakings reflects clause 97 of the Determination, and clause 97 is not expressly subject to clause 4(3) of the Determination, clauses 37, 38, 63 and 64 of the Determination require Telecom to limit disclosure by the relevant business unit and all its employees, agents and contractors (emphasis added).

8.8 Telecom is focused on the major changes separation has on Telecom. It has major changes for access seekers also. The fact that Telecom outsources should not justify significantly different confidentiality requirements.

9. ***Scope of business of the ANS Unit***

9.1 Clause 13.2 of the Undertakings provides that the board or CEO of Telecom may amend the ANS Unit's scope of business from time to time. We submit that any variation of the scope of business of the ANS Unit is a variation of the separation plan that has to be agreed to by the Minister in accordance with S.69U of the Act.

9.2 While clause 13.2(a) of the Undertakings provides that the ANS Unit's scope of business cannot be materially reduced from that provided in clause 13.1 of the Undertakings, clause 13.1 does not:

9.2.1 State that the ANS Unit must control the access network (this is provided in clause 14.1) or

9.2.2 That the ANS Unit must have sufficient influence over other assets (see clause 16);

10. ***ANS Unit will control the Access Network***

- 10.1 In the Determination *Local Access Network* includes all fixed wireless access systems when used as a copper substitute or copper replacement (but not including cellular mobile systems).
- 10.2 Clause 14.2 of the Undertakings has excluded any fixed wireless access systems from the definition of *Local Access Network*.
- 10.3 Clause 15 of the Undertakings provides that where a Telecom fixed wireless access system is in an area in which there is no Telecom Local Access Network any service that the ANS Unit provides that exclusively or mainly uses those systems will be a Relevant Access Service subject to the Undertakings.
- 10.4 The Undertakings are narrower than the Determination, as it is not a condition in the Determination that only a fixed wireless access system in an area where there is no *Local Access Network* is to be subject to the Undertakings.

11. ***ANS Unit to provide relevant services***

- 11.1 Sub-clause (c)(iv) of clause 18.2 of the Undertakings provides that relevant network access services do not include any Mobile Services. By contrast clause 21(2)(b)(iv) of the Determination excludes Regulated Mobile Services [*#Note: Should this be changed?*].
- 11.2 Clause 21 of the Determination defines the relevant services to be provided by ANS. By way of example the Determination specifically includes LLU Backhaul (including both distribution cabinet to telephone exchange and telephone exchange to interconnect point). Under clause 9 of the Determination

Telecom must provide EOI for relevant services. As Telecom is required to provide EOI for LLU Backhaul to the cabinet (and the corresponding co-location service) on an EOI basis, Access Seekers and Telecom Wholesale must be given access to all cabinets and backhaul to the cabinet on the same timeframe and under the same terms. If Telecom Wholesale has access to the cabinets prior to other Access Seekers they will have significant advantage over Access Seekers and discourage alternative investment.

- 11.3 Telecom has included in Schedule 1 a migration plan for only some of the services included in Schedule 1 of the Act, all of which are included in the definition of Relevant Services. The migration plans must be amended to include all Relevant Services as defined by the Determination.
- 11.4 New cabinets will be used by both Access Seekers and Telecom on the same terms and timeframe. Therefore ANS should be required to consult with all Access Seekers over the design of new cabinets. Cabinet design needs to be selected to ensure other Access Seekers can also install equipment in cabinets and take advantage of the Local Loop and Sub-Loop Determinations. This will ensure the highest incentives for alternative investment and most efficiently achieve the purposes of Part 2 of the Act.
- 11.5 EOI for providing services to end-users served by cabinets is not included in the Draft Undertakings, even though Telecom will be required to under Part Two of the Act, likely to be during the migration period, as the service is included in schedule 2 of the Act.
- 11.6 For existing cabinets the transfer to equivalence would be part of the Determination for LLU Backhaul to the cabinet.

However for new cabinets, Access Seekers and Telecom Wholesale must be given access to those cabinets and backhaul on an EOI basis from installation. This is not provided for in the current Draft Separation Undertakings. ANS providing access to new cabinets to Wholesale prior to other Access Seekers does not meet EOI requirements, creates extra costs for Telecom (to first give access to Wholesale, and then migrate to EOI), and impacts negatively upon competition.

12. ***Employees of ANS Unit may not work for any other Telecom business unit***

12.1 Under clause 30 of the Determination, no person who is an employee working for the ANS Unit may work for any other Telecom business unit.

12.2 In clauses 26.2, 38.2, 62.3 and 70.2 of the Undertakings Telecom has added for the avoidance of doubt provision, which we consider creates doubt. While we accept that an employee working for the ANS Unit may do work for another part of Telecom on behalf of the ANS Unit (i.e. the ANS Unit is engaged by the other part of Telecom, not the individual employee), an employee of the ANS Unit should not in any circumstances work for the other part of Telecom as an employee under contract of service or services.

13. ***ANS Unit will not discriminate***

13.1 The Determination states that the Undertaking must provide that the ANS Unit, when doing or omitting to do anything in relation to the supply of relevant network access services, will not discriminate between access seekers and other Telecom business units or between access seekers.

13.2 In clause 31.2 of the Undertakings Telecom has inserted an avoidance of doubt provision, which appears to permit volume discounts. As Telecom's other business units are likely to be significant users of the services, we are of the view that otherwise would be legitimate business practice could become discriminatory.

14. ***Establishment of Wholesale Unit***

14.1 Under the Act Telecom must operate its wholesale business unit or units at arm's length from any business unit that provides retail functions. In addition, Telecom must operate its ANS Unit on a standalone basis, at arm's length from any other Telecom business unit. Accordingly, clause 43.2 of the Undertakings must make it clear that Telecom cannot choose to include the Wholesale Unit as part of either a Retail Unit or the ANS Unit.

15. ***Wholesale Unit will provide relevant wholesale services***

15.1 In the Determination *Relevant Wholesale Services* means, inter alia, all packet-based bit stream services that enable access to, or interconnection with, Telecom's NGN Core, including IP interconnection.

15.2 In the Undertakings Telecom has inserted a clause 66 that specifically addresses IP interconnection, stating that IP interconnection occurs between retail service providers and that the approached IP interconnection remains the subject of industry discussion in New Zealand and internationally.

15.3 Clause 66.3 of the Undertakings states that where Telecom provides IP interconnection to access seekers it will do so on

commercial terms that are fair and reasonable in the circumstances.

15.4 Clause 66.4 of the Undertakings provides that nothing in the Undertakings requires Telecom to provide IP interconnection to an access seeker if the access seeker refuses to provide Telecom with a similar service on commercial terms that are fair and reasonable in the circumstances.

15.5 Unless the Determination is amended, clause 66 of the Undertakings does not comply with the Minister's Determination and should be deleted.

16. ***Wholesale Unit will not discriminate***

16.1 We note that pursuant to clause 56.1 of the Undertakings the Wholesale Unit is prohibited for discriminating between Access Seekers and Retail Units or between Access Seekers in the provision of Relevant Wholesale Services.

16.2 However, we are concerned that there may be some latitude for Telecom to claim that it is not required to operate at 'arm's length' (or to put it another way, is not bound by the non discrimination clause) where it has not yet met or is unable to meet the 'binding' commitments contained in the migration plan for achieving Resale Equivalence standard and/or EOI.

16.3 We suggest the inclusion of a new sub clause into clause 56 of the Undertakings as follows:

56.2 For the avoidance of doubt, clause 56.1 applies whether or not the Wholesale Unit has met or is likely to meet the binding commitments contained in the migration plan (including timeframes) set

out in Schedule 1, or where there is no such migration plan, in accordance with a migration plan (including timeframes) approved by the Commission.

- 16.4 We are concerned that having the positive obligation for the Wholesale Unit not to discriminate in respect of provisions of the Relevant Wholesale Services, is not seen to diminish in any way, the legal obligations on the Wholesale Unit not to discriminate (including competition law obligations) in respect of the provision of any non Regulated services.
- 16.5 We suggest consideration of the inclusion of a further sub clause as follows [and the subsequent renumbering of the following sub clauses]:

56.3 For the avoidance of doubt, without limiting the generality of clause 52.3 or clause 56.1 nothing in these Undertakings permits the Wholesale Unit to discriminate in the doing or omitting to do anything in respect of the provision of any non Regulated service (whether statutory or otherwise).

17. Wholesale Unit's incentive arrangements

- 17.1 At clause 60.5(c) of the Undertakings Telecom provides, for the avoidance of doubt, that the incentive remuneration of the Manager of the Wholesale Unit might include up to 80% based upon the performance of Telecom as a group.
- 17.2 This goes directly against the concept of operational separation. In particular we submit that Telecom Retail Unit(s) under the proposed separation will not only be a direct

competitor of Access Seekers but will also be a major contributor to Telecom Group revenues and therefore performance.

- 17.3 To have the Manager of the Wholesale Unit that supplies products and services to Access Seekers, who are in direct competition with Telecom Retail, remunerated to a potentially significant extent, based upon the success of the competition to the detriment of Access Seekers' performance is inappropriate and should not be permitted.
- 17.4 The Manger of the Wholesale Unit should be remunerated solely on the basis of the performance of that unit to the exclusion of other parts of the Telecom Group.

18. ***FTTP Access Service***

- 18.1 Clause 65.4 of the Undertakings provides that nothing in the Undertakings requires the Wholesale Unit to provide a FTTP Access Service to an Access Seeker if the Access Seeker refuses to provide Telecom with any similar service in New Zealand.
- 18.2 Clause 23 of the Determination however contains additional requirements than those contained in clause 65 of the Undertakings. For example at clause 65.4(b) of the Undertakings, Telecom has inserted a *for the avoidance of doubt* clause which is arguably narrower than the provisions of clause 23(2) of the Determination, thereby increasing Telecom's ability to refuse access to a service.
- 18.3 Kordia submits that unless the Undertaking is amended, clause 65 of the Undertakings does not comply with the Minister's Determination and should be amended.

19. ***CEO and Board Role***

- 19.1 Throughout the undertakings Telecom have narrowed the scope of the Determination as it applies to the CEO and Board by replacing the terms "*do not limit*" the duties and roles with the terms "*do not apply to*" those duties and roles. This broadening may have unexpected and damaging consequences to achieving the purposes in the Act and should be amended.
- 19.2 Clause 7.4 qualifies that the transparency requirements of the IOG with the Board and CEO only apply to significant decisions. Where the Board or CEO is involved in a decision, it should be considered a significant decision and therefore subject to the transparency requirements. Such a qualification could result in unexpected and damaging consequences.
- 19.3 Clause 7.4 (a) (i) includes a further qualification that documentation relating to the significant decision need only be provided to the IOG for investment decisions where capital expenditure is in excess of 10% of the annual capital budget of the relevant unit. Investment decisions by Telecom smaller than 10% may have a significant impact on the market and this qualification should be removed.
- 19.4 Clause 7.4 (a) (ii) also qualifies that these requirements only apply where they have a material impact on the operation of these undertakings. Clause 7.4 should apply to any matter relevant to the Act, the Determination or the Undertakings.
- 19.5 Clause 7.4 (b) qualifies that documents provided to the IOG must be "*reasonably requested*". Qualifications such as reasonable, significant and material introduce opportunity for

Telecom to delay and argue such requests. This will be detrimental to transparency, and such qualifiers should be deleted.

- 19.6 Clause 7.5 (c) also qualifies that disclosure requirements do not apply to the Board or CEO where the decision relates *“to the annual and long-term corporate plans and technology plans of the ANS Unit or the Wholesale Unit.”* This allows the CEO of Telecom to deal with annual and long-term plans as he/she sees fit. Such annual and long-term plans should be subject to the same disclosure requirements to the IOG as any other decision by the Board or CEO.

20. ***Migration to Equivalence***

- 20.1 The migration plan to EOI is outlined in Schedule 1. It outlines how Telecom’s existing, and some of the planned regulated services, will be migrated to EOI standards. The migration plan does not include all regulated services as required by the determination and takes too long to reach EOI. Furthermore, there need to be measures to achieve levels of equivalence prior to full EOI at the end of the migration period.
- 20.2 For new cabinets and exchanges EOI should be provided for immediately. As it is new infrastructure there is no need for a migration from Wholesale only. Wholesale and Access Seekers should be given access to those new cabinets and exchanges at the same time, to more efficiently achieve the equivalence requirements in the Determination.
- 20.3 While equivalence is the end result of the migration, there need to be proxies to equivalence during the migration plan. While Telecom provides this near the end of the migration

period, these "EOI Building Blocks" need to be provided sooner. Furthermore, during migration to EOI, the units of Telecom should be required to operate as separate units, to ensure Telecom does not favour itself over other Access Seekers.

20.4 Kordia and Orcon believe a 4 year migration for Telecom to be fully compliant with EOI is far too long. We therefore ask the Minister to revise the timeframe in clause 9 of Schedule 1 of the Determination to provide for an earlier date.

21. ***Cabinetisation***

21.1 Specifically in response to Telecom's cabinetisation announcements on the 21st of November, it is essential that EOI is implemented effectively. On the 22nd of November, Telecom provided further information that the copper access line would still provide voice services by Telecom Wholesale, from the exchange, and only Broadband services would be provided from the cabinet. If ANS provides a copper access service (substantially the same as the UCLL service) to Telecom Wholesale, in order to be compliant with EOI requirements in the Determination and Act Telecom must also make that UCLL service available to all Access Seekers on the same regulated terms in the UCLL Standard Terms Determination.

21.2 Clause 38.10.1 of the UCLL STD General Terms states Telecom must give 24 months notice to the Access Seeker for cessation of supply of the UCLL service. If ANS makes the service available to Telecom Wholesale (to provide voice or other services), there is no cessation of supply. To be compliant with EOI requirements the service must still be available to Access Seekers with a 24 month notice period of

when the service will cease to Telecom Wholesale and all other Access Seekers.

22. ***General Issues***

22.1 Kordia and Orcon encourage the Ministry to recommend the Undertakings apply to all of Telecom in New Zealand. The exclusion of the wireless access network from the undertakings is contrary in principle to the Act. The Act was written to be technology neutral. Therefore mobile and wireless Access Networks should be included in the ANS unit of Telecom, while Telecom's retail mobile operations should be included in the Telecom Retail unit.