



**Response to Telecom's
Amended Separation Undertakings**

25 January 2008

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1. Introduction

- 1.1 The mission of InternetNZ, the Internet Society of New Zealand Inc, is to protect and promote the Internet for New Zealand. We advocate the ongoing development of an open and uncaptureable Internet, available to all New Zealanders. The Society is non-partisan and is an advocate for Internet, and related telecommunications, public and technical policy issues on behalf of the Internet Community in New Zealand – both users and the Industry as a whole.
- 1.2 InternetNZ welcomes this opportunity to provide submissions to the Minister on the Amended Undertakings (*Telecom Separation Undertakings*) prepared by Telecom in December 2007.
- 1.3 In making this submission, InternetNZ notes that many of the detailed suggestions it has made in the past (For example in *InternetNZ Response to Telecom Draft Separation Undertakings, 23 November 2007*) have not been taken into account.
- 1.4 The following section summarises our key points taking into account the Amended Undertakings and Amended Determination, and subsequent sections analyse selected issues in greater depth. “MD” refers to the Minister’s Determination as amended. “TU” refers to Telecom’s Undertakings as amended.

2. Key Points

- 2.1 The revised Undertakings are, broadly speaking, an improvement on the previous version. InternetNZ is pleased to note that many of the suggestions made in detailed submissions by a range of parties have been adopted.
- 2.2 Fundamental to operational separation is the issue of incentives: the purpose of this regulatory framework is to align incentives on the separated entity with the broader interests of competition for the long term benefit of end users.
- 2.3 The Minister’s amended Determination, allowing group incentives for the Wholesale division manager, seriously undermines the incentives structure that operational separation is aimed at putting in place.
- 2.4 The remaining elements of the Undertakings will need to be strengthened to ensure the objectives of operational separation can as best as possible be achieved. There is plenty of scope for such strengthening, given the Undertakings do not in places meet the minimum requirements of the Determination.

2.5 InternetNZ assumes that the earlier comprehensive submissions it lodged are still being considered in the Minister's ongoing review of the latest draft Undertakings.

2.6 InternetNZ recommends that the current draft Undertakings not be accepted, and that the Minister use his powers under the Act to amend parts of the Undertakings to achieve an operational separation that meets the Act's requirements and that can achieve the long term benefit of end users.

3. Wholesale Remuneration

3.1 The Undertakings are to give effect to the Telecommunications Act's requirements for robust operational separation of Telecom into three divisions, with additional requirements for the separation being set out in a Ministerial Determination.

3.2 The Minister's amendment of the Determination, made without consultation just before Christmas, undermines operational separation. It encourages a rational Wholesale Manager to put the interests of the group at the core of their work. Allowing incentives only on the basis of Wholesale division performance, as previously required, aligned incentives on Wholesale with pro-competitive behaviour. That is no longer the case.

3.3 The Minister has been reported as saying that the CEO of BT Wholesale is entitled to group remuneration, as a justification for the amendment. However, the BT Undertakings are clear in respect of disallowing such group incentives for wholesale managers and staff identified in the BT Undertakings.

3.4 Even assuming that there are Wholesale employee/s that are outside the staff named in the BT Undertakings, this raises the question of whether the BT Wholesale CEO position is in a comparable position to the Wholesale Manager role envisaged for Telecom. Additionally, in a smaller company with a more dominant market position, and in view of the increased importance of the Wholesale division as identified in the InternetNZ and TelstraClear submissions, a stronger focus on pro-competitive outcomes is justified in relation to the Wholesale division.

3.5 The wholesale unit, and the services it will provide, will have increasing significance, as against the services provided by ANS ("Chorus"). There is a real prospect that the wholesale unit will, in the medium term – be the most important component of the structure (as opposed to ANS).

3.6 That is consistent with Ofcom's views. Given the nature of Telecom's cabinetisation announcements in November 2007, and the consequent challenges for LLU business cases, the Wholesale division, and its services, appear destined to become more pivotal in the short term.

3.7 InternetNZ endorses the TelstraClear submission on the draft Undertakings, regarding concerns on the timing of LLU, operational separation when compared to the UK, and NGN developments – specifically the pivotal importance of the Wholesale division in achieving the desired policy outcomes from Operational Separation.

3.8 InternetNZ submits that the amended determination, allowing group remuneration for Wholesale, was arrived at without following administrative law requirements. Specifically the Amended Determination was made without consulting affected parties. Consultation as to the draft Undertakings (when the Determination which disallowed group remuneration for Wholesale was not in contention) does not constitute consultation on whether the determination should be varied.

- 3.9 In light of this, the Minister should recommence the amended Determination process and consult before amending the determination.
- 3.10 The amendment to the Determination was made without consultation with affected parties beyond Telecom. Consultation as to the draft undertaking (when the Determination which disallowed group remuneration for Wholesale was not in contention) is not, in any way, consultation on whether the determination should be varied. The amended determination is therefore not one that has been arrived at following the clear requirements of administrative law, and the Minister should either confirm this, and go out to consultation, or find some other solution, such as considering a further variation, after consultation.
- 3.11 InternetNZ fully appreciates and accepts that these Undertakings are a product of very detailed negotiation and invariably as with all negotiations, will involve trade-offs. The difficulty in this instance lies in understanding both the nature and rationale for this trade-off, which it must be noted is a major deviation from the BT Undertakings.
- 3.12 In view of amendment concerning wholesale incentives, it therefore becomes paramount that all the remaining provisions in the undertaking relating to the wholesale division and its services be carefully considered to ensure the wholesale division fully complies with the overall intent of the Undertakings.
- 3.13 It is not possible for InternetNZ to recommend specific alterations on many issues, such as provisions that tighten compliance with the Undertakings. That is because, understandably, only the officials (and Telecom) have the detailed knowledge of particular decisions, trade-offs, etc, and there are numerous issues. No submission can get anywhere near the months of detailed discussions on so many inter-meshed provisions. Industry and end-users are heavily reliant on officials' and Government's work in this area. Additionally, the complexity is such that InternetNZ (and other submitters) don't have the resources to deal with this in detail.

Recommendation

- 3.14 **That, as well as reconsidering the Amended Determination as proposed above, Government ask officials to closely review and require amendment of the draft undertaking as to the Wholesale division, and the services it offers, to ensure there are robust provisions that apply to the Wholesale unit and services provided by that unit, taking into account the analysis of the Wholesale unit's role by InternetNZ and TelstraClear in their submissions on the draft undertaking (which should be revisited in light of this submission), the impact of the Telecom cabinetisation decision, and the provisions of the Act and the Determination as varied.**
- 3.15 The following sections provide additional commentary on many of the most critical issues, in the context of the point made in the previous paragraph.

4. Fibre services

- 4.1 Transparency about future developments is a key requirement of operational separation, critical to industry confidence and investment decision-making.
- 4.2 In respect to fibre rollout, Telecom is required in clause 23(1) of the Determination to provide detailed commercial policy for access to FTTP services in the separation Undertakings.

- 4.3 Detailed commercial policy is not included in the current version of the Undertakings. This is a glaring omission.
- 4.4 Telecom must be required to comply with Clause 23(1) of the Determination on this point to avoid the operational separation eroding over time.
- 4.5 This requires full disclosure of Telecom's FTTP policies and plans relating to:
- service development
 - pricing
 - marketing and intelligence
 - service launch dates
 - costs
 - non-price terms, including payment terms
 - products specific forecasting
 - network coverage and capabilities
- 4.6 Telecom has added further commitments to consult, for example regarding certain aspects of IP interconnection and the establishment of an industry-wide NGN consultation programme (cl 67 TU). This is to be welcomed but InternetNZ recommends that would best be achieved through an arms-length, independent entity and process, separate from Telecom, modelled on NGN UK, and that there are specific timelines attached (subject to the need to not delay ongoing commercial progress in resolving interconnection issues). Ofcom in the UK has published extensive reports on how best to approach this consultation, and these should be considered in developing effective consultation on these matters in New Zealand.

5. Inadequate arms-length for future services

- 5.1 The arms-length features of the Undertakings need to be as strong as possible, especially given the change to management incentives in the Amended Determination.
- 5.2 Except where specified otherwise, a robust operational separation of Telecom requires that the arm's-length rules apply to not only the relevant services that are actually provided to Service Providers, but also to relevant services that are not then provided to Service Providers (for example, yet-to-be regulated services and services in development).
- 5.3 Failure to adequately protect against inappropriate influence and access to information in relation to Services that are not yet delivered to Service Providers could have obvious adverse affects when those services are actually provided.

No protection from Employee participation and access to information

- 5.4 Telecom still requires that the restrictions on participation in the making of ANS/Wholesale Unit plans and policy, and access to ANS/Wholesale Unit Customer Confidential Information and Commercial Information, only apply in relation to the Relevant Services that the ANS / Wholesale Unit actually "provides Service Providers with" (cl 88.4, 88.5 TU). The Determination contains no such restriction (see cl 14(4) MD).
- 5.5 Telecom's change means that non-ANS/Wholesale Unit employees are permitted to participate in plans and policy related to yet-to-be-provided services and access sensitive information about the same. Such participation and access could well result in inappropriate decisions or actions that disadvantage service providers.
- 5.6 Telecom should be required to adopt the approach set out in the Determination.

Disclosure of Wholesale Unit and Fixed Network Business Unit Commercial Information

- 5.7 Clause 79(2)(a) of the Determination provides for a limited right to disclose Commercial Information to the retail unit. Telecom has implemented this right at clause 59.2 but failed to limit it to disclosure to the retail unit. So, Telecom has provided for itself a broader right of disclosure than is permitted by the Determination. As with any of the other permitted carve-outs from the arm's-length rules, the Undertakings should strictly follow what is permitted by the Determination.

6. Role of the CEO

- 6.1 The revised Undertakings still provide for the CEO to have a degree of latitude in his/her dealings that are not permitted by the Determination and risks compromising the robust operational separation of Telecom.

Day-to-day management

- 6.2 The CEO may, without any substantial checks and balances, participate in the day to day management of the Executive (cl 7.4(b) TU). One can easily foresee a number of circumstances in which the line between day-to-day management and participation in decisions could become blurred. Further, this broad right is contrary to the express requirement that the ANS Unit remain solely responsible for its day-to-day management (cl 28.1(b)).
- 6.3 At the very least, it is still appropriate that the CEO's day-to-day management be subject to the disclosure requirements in cl 7.3 TU in the case of participation in any "significant decision".

Arm's-Length rules

- 6.4 The CEO is still excluded from the definition of "Employee", contrary to the Determination. An example of why this is a problem is that he or she is not subject to most of the general arm's-length rules applicable to all employees (cl 14 MD). While some latitude for the CEO is appropriate, particular care is required and, in any event, the minimum requirements of the Determination must be met.

Approval of plans

- 6.5 The addition to the end of clause 17.1 TU, which requires ANS Unit key responsibilities to be in accordance with applicable Board- or CEO-approved plans, is not a condition that is permitted by the Determination nor is it consistent with policy.

7. Telecom-wide policy

- 7.1 Telecom has introduced a further exception to the prohibition that non-ANS/Wholesale Unit employees can participate in the making of ANS/Wholesale Unit plans and policy by providing that it is still permitted to centrally set "commercial policy of a general application" (cl 88.6 TU).
- 7.2 InternetNZ considers this carve-out to be too broad, vague and poorly worded: even commercial policy (noting the wide definition of that term) that is generally applicable to Telecom could be used to influence the making of ANS/Wholesale Unit plans and policy.
- 7.3 If it is essential that there be Telecom-wide commercial policy then it should be carefully vetted in advance by the IOG to ensure that it does not influence the policy and plans of the ANS and Wholesale Units.

8. Relaxed arm's-length rules

- 8.1 The Determination permits limitations to the general rule that the Wholesale Unit must act at arm's-length to the Retail Unit (cl 57(5) MD). However, Telecom's limitations (see cl 52.3 TU) do not meet the following criteria for limitations set down by the Determination:

*"the limitations apply to the extent and for the period reasonably justified for the purpose of facilitating appropriate non-discriminatory contact between the wholesale unit and the retail unit in order to avoid unreasonable constraints on new product and service development."*¹

- 8.2 The failure to cater for these express requirements is significant. For example, cl 52.3 TU fails to comply with the requirement that the contract between the Wholesale Unit and Retail Unit in relation to a new product or services must be of a "non-discriminatory" nature.
- 8.3 Further, Telecom has failed to capture the fact that any limitations on the Arm's-Length Rules may only apply "to the extent ... reasonably justified ...". Telecom's introductory words of "to enable" do not capture the restrictive and proportionate nature of "to the extent" and so permit overly broad grounds for avoiding the Arm's-Length Rules (particularly given the failure to capture any protections against non-discrimination).
- 8.4 Clause 52.3 TU is a particularly large carve-out which is not justified by cl 57(5)(b) of the Determination (quoted above) and is inconsistent with the policy underlying operational separation. Innovation in the sector is to be encouraged but, overall, so-called "innovation" in this way will have the opposite effect by discouraging innovation from providers generally, Telecom having pre-empted them via this carve-out.
- 8.5 Any exceptions to the foundational Arm's-Length Rules should be both clear and restrictive. InternetNZ is of the view that the Determination anticipated that any limitations would be set out with greater specificity than Telecom has so far done and would also more accurately reflect the express requirements of the Determination.

9. Employees working for more than one part of Telecom

- 9.1 The new changes to cl 26.2, 38.2, 54.2, 62.3 and 71.2 are an attempt to reduce the significant risk posed by employees working for more than one Unit. However, these changes are inadequate.
- 9.2 The IOG, on the changed provisions, would always see the agreement after the event (i.e. too late). This may not matter for minor situations but, for example, this clause permits substantial, long term and irreversible contracting. The clause should provide for pre-approval of the agreement by the IOG or that the agreement is conditional on IOG approval within a specified period. The IOG could always give blanket approvals to certain types of engagements (i.e. for "business as usual").

Utilisation of Shared Services

- 9.3 Similar issues arise in relation to the ability of Shared Services personnel to carry out the work of any Required Telecom Business Unit (cl 99 TU). Telecom's changes to cl 99 still do not deal with the risk of inappropriate discrimination, disclosure and influence. Clause 99 of the Minister's Determination requires that any such arrangements must comply with the Determination and s 69D of the Act. Accordingly, to implement a robust operational

¹ cl 57(5)(b) MD

separation of Telecom, InternetNZ considers it appropriate to adopt TCL's recommendations of the implementation of strict Chinese walls and notification to, and monitoring by, the IOG.²

Restricted public disclosure

- 9.4 Clause 89 MD permits Telecom or the IOG to remove confidential or commercially sensitive information from reports that are to be made available to the public. This right is limited to information that the IOG has "agreed is confidential or commercially sensitive information **that can be removed**" (emphasis added). This approach seems to acknowledge that at times confidential/commercial information should not be removed.
- 9.5 Telecom has not included the required reference to "that can be removed" in cl 86 TU. InternetNZ is concerned that this omission could be used by Telecom to undermine the level of disclosure and transparency that is required to effect and maintain a robust operational separation. The IOG should have the ability to disclose confidential or commercially sensitive information in appropriate circumstances, which we expect to be relatively rare.

10. Additional carve-outs from non-discrimination

- 10.1 Clauses 31.2 and 56.2 TU still contain, despite changes, a significant carve-out from the essential prohibition on the ANS and Wholesale Units from discriminating between service providers and other Telecom Business Units.
- 10.2 While Telecom has made some changes to these clauses, the ANS and Wholesale Units may still choose to discriminate on the basis of the requirements of their most significant customers: the Wholesale Unit and Retail Unit (respectively). For example, the volumes required by the Wholesale and Retail Units could well result in volume discounts that significantly disadvantage service providers. Also, the Wholesale Unit is permitted by this provision to, in most cases, favour its largest customer, Telecom Retail. InternetNZ is concerned that an exception such as this could easily result in discriminatory behaviour that could seriously undermine operational separation.

11. Miscellaneous issues

Priority of Part 2

- 11.1 Telecom has retained the provision that provides that Part 2 of the Undertakings prevails over any of the other Parts in the event that there is any inconsistency (cl 8 TU). As previously submitted, this priority regime was not considered necessary in the Determination and its introduction may well result in unintended consequences. It is not appropriate that the provisions in Part 2 of the Undertakings should always "trump" the rest of the Undertakings.
- 11.2 It is particularly troubling that Telecom has chosen to include the generic provisions relating to the role of the Board and CEO in this priority Part, while they have not included the similarly important general rules in relation to all personnel (which were also in the section of the Determination (cl 14 MD) dealing with the general arm's-length rules).

² Page 35, TelstraClear Submission: *Submission relating to Telecom Draft Separation Undertakings*

Omission of express references to the Act and Determination

- 11.3 The Undertakings must comply with section 69D as well as the Determination.
- 11.4 InternetNZ remains concerned that Telecom has in a number of places failed to include express reference to the Act and Determination in the manner required by the Determination (for example, compare cl 98 MD with cl 98 TU).
- 11.5 InternetNZ can see no reason why the Board, CEO and Employees should not be subject to a clear requirement to give effect to Part 2A of the Act and the Determination. Telecom has omitted this clear requirement from the Determination (cl 14 MD) in its cl 88.1 TU.
- 11.6 It is appropriate that the Undertakings recognise the requirements of the Act, particularly so as to clarify the overall intentions of the Undertakings, on which a number of provisions rely (for example, cl 26.2(a) and 97.1(b) TU).

Limitation on the requirement to provide services

- 11.7 Clause 6 TU (as to the limitation on the requirement to provide services) is narrower than, and different from, Clause 8 MD. For example there is reference to commercial agreements (that gives unilateral control on that limb of the provision to Telecom as of course it must agree to enter the agreement). That is not in the determination. Clause 6 TU does not need to differ from Clause 8 MD: it should use the same words.

“Eligible Service Provider”

- 11.8 Telecom has introduced the new definition of “Eligible Service Provider”. In a number of cases the term is used to replace the reference to “service providers” as required in the Determination (for example, cl 34.1, 59.1, 88.4(a) TU).
- 11.9 Because the definition of “Eligible Service Provider” is substantially narrower than “service provider” Telecom has lowered the threshold for which:
 - 11.9.1 Telecom Fixed Network Business Units and the Retail Unit may disclose Commercial Information (see cl 34.1, 59.1, 72.1 and 76.1 TU); and
 - 11.9.2 employees are permitted to participate in the making of plans and policy and access Customer Confidential Information and Commercial Information (for example, see cl 88.4 and 88.5 TU).
- 11.10 This change was neither required nor anticipated in the Determination and should not feature in the Undertakings. At the very least, service providers that have not yet signed up for a service may suffer as a result of this lack of transparency in relation to Telecom’s plans and strategy.
- 11.11 In any event, the definition of Eligible Service Provider is too narrow. To qualify:
 - 11.11.1 the provider must have an agreement with Telecom (i.e. Telecom can decide unilaterally whether this happens);
 - 11.11.2 the provider must be a party to a section 27 Determination (that is a rarity as usually one (of many) carriers is a party); or

11.11.3 there must be a Standard Terms Determination or a Registered Undertaking (that leaves out, potentially, a number of actual and potential service providers).

Documentation disclosed to the IOG

11.12 The documentation to be provided to the IOG under clauses 7.3(a) and (b) TU is more restrictive than the documentation that must be provided under clause 15(5) MD. The Undertakings should be amended to reflect the clear requirements of 15(5) MD.

12. Conclusion

12.1 InternetNZ commends the Minister, his officials and Telecom for the substantial progress that has been made in developing operational separation for New Zealand in the past six months.

12.2 As detailed above, last year's changes to the Determination require the treatment of various aspects of the Undertakings to be toughened compared with the status quo, and in line with the suggestions from InternetNZ and other parties made in the last round of submissions. Only some of the key issues are canvassed here.

12.3 InternetNZ reiterates its recommendation that the Minister not accept the current Undertakings, but work to further improve them before signing them as set out at paragraph 3.14 above.

12.4 Thank you for the opportunity to make this submission.

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