

25 January 2008

Operational Separation Submission
ICT Regulatory Team
Ministry of Economic Development
PO Box 1473
WELLINGTON

Dear Sir/Madam

**Operational Separation
Comments on the Amended Plan**

1. TelstraClear welcomes the opportunity to comment on the amended Telecommunications (Operational Separation) Amendment Determination 2007 and Telecom's draft separation undertaking.
2. TelstraClear is supportive of amendments that have been made to ensure that Next Generation Network ('NGN') products are built with Equivalence of Inputs ('EOI') from the outset, and the strengthening of disclosure requirements to the Independent Oversight Group ('IOG').
3. However, TelstraClear continues to have concerns with the amended separation plan, which we consider create a risk that the overall objectives of operational separation will be undermined, and that the opportunity to proactively address access issues in an NGN environment will be missed.

Wholesale access in an NGN environment

4. In our submission¹, TelstraClear identified the gathering international evidence that bitstream will become an increasingly important wholesale access mechanism as Fibre to the Node ('FTTN') investment occurs to improve network capability in an NGN environment.
5. Ofcom has described this as a shift from a reliance on access to "passive elements" (i.e. Local Loop Unbundling - 'LLU') to access to "active elements" (i.e. bitstream) as the cornerstone of the regulated NGN access regime. As Telecom deploys FTTN ('cabinetisation'), it is probable that LLU will become uneconomic for access seekers in many areas of New Zealand.

¹TelstraClear, *Submission relating to Telecom Draft Separation Undertakings*, 23 November 2007.

6. The challenge New Zealand faces is that the delay in mandating LLU has meant that its introduction coincides with the transition to NGN. TelstraClear therefore considers that it is crucially important, for access seekers and incumbents alike, that the access requirements in an NGN environment be settled as commitments to invest are made and accepted.
7. The revised draft undertaking does not address the concern raised in our prior submission that although, in an ideal world, operational separation might not be the best vehicle to deal with NGN access commitments, alternative regulatory processes are unlikely to be concluded before Telecom's cabinetisation program is well underway. Therefore, if Telecom Wholesale is to supply the NGN bitstream services it should be subject to the same full range of operational separation rules as ANS (which remains limited to the supply of unbundled loops and associated backhaul). This would align the proposed New Zealand operational framework with the UK model, which is built around two "pillars", imposing the full range of safeguards on both the access network and wholesale units.
8. Many of the issues for which operational separation is meant to solve in a legacy environment will not arise if access is provided to a raw bitstream service at open interfaces that give access seekers the same level of control over QoS, functionality and speed as the incumbent's downstream units connecting at the same interfaces.
9. Telecom has separately said that ANS may provide an "unbundled ports service", which could provide such access (and may therefore be similar to the NGN bitstream services that Telstra has proposed for Australia as part of an FTTN deployment). TelstraClear remains of the view that Telecom should be required (as part of its operational separation Undertaking) to lodge an undertaking in relation to the unbundled ports service so as to provide the basis for ongoing competitive impetus in an NGN environment.
10. Likewise, Telecom should be required to lodge an Unbundled Partial Circuits undertaking as a condition of the approval of the operational separation undertakings.
11. TelstraClear also remains of the view that, because the proposed Undertakings do not set out a clearer set of obligations in relation to equivalent access in an NGN environment, the remuneration incentives for both ANS and Wholesale must drive performance based on unit rather than company-wide performance. Consequently, we consider that localizing incentives for both ANS and the wholesale unit are important to ensure all access seekers, including Telecom Retail, are treated equivalently.
12. For that reason, the provision of a specific exception for the manager of the wholesale unit is inconsistent with that objective. In effect, the manager of the wholesale unit is almost as incentivised by Telecom's overall performance (which will be retail-skewed) as by his or her own responsibilities as head of wholesale. At best, this neutralizes his

or her incentives in relation to the wholesale business. Again, if the proposed Undertakings set out a clearer set of obligations in relation to equivalent access in an NGN environment, there would not be the same need to “channel” the incentives of employees of ANS, Telecom Wholesale and the network units that control NGN infrastructure to ensure that Telecom gets to that outcome.

The Migration of POTS access services

13. TelstraClear is still concerned that the draft undertakings do not clearly describe the migration pathway for switched telephone services. It is unclear whether a switched telephony resale product will continue to be available after EUBA is available for 80% of all PSTN lines and there is no clear description of a wholesale line rental service.
14. Further, Telecom state that they would prefer a Voice Over Broadband PSTN migration option to PSTN emulation. As Telecom acknowledge, this is likely to have a lower take-up initially as changes need to happen at the customer’s premises. Access seekers should have a viable means of offering end-users a POTS service for so long as Telecom itself continues to retail such services and the demand for such services remains significant. LLU is unlikely to be viable in many areas and EUBA is not a sufficient wholesale input on its own to meet the demands of all end user customer segments due to the customer migration issues that Telecom acknowledges.
15. This issue is of particular concern given the provisions around the potential withdrawal or grandfathering of resale services once retail services developed after the approval date of the undertakings consume Wholesale Unit input services provided in accordance with the December 2009 Requirements.² Until the PSTN is closed entirely, Telecom Retail will have the choice of offering a POTS service to its end customers or Voice over Broadband. To be able to compete with Telecom across all customer segments, access seekers need to be able to viably replicate such offerings. If LLU or other infrastructure based supply is unviable then a resale POTS or wholesale line rental product will be required.
16. Finally, any exclusion of future retail services from Relevant Wholesale Services that the Telecom Wholesale Unit will provide should only apply to retail services developed once the December 2009 requirements are met, not for any services developed between the approval date and the date Telecom meets the December 2009 requirements.

Price Equivalence

17. TelstraClear remains concerned that the draft undertaking does not address requirements for achieving price equivalence in the supply of services to downstream units and access seekers that match the non-price equivalence achieved by EoI.

² In accordance with clause 45.2(b)(iii) and clause 64.5.

18. The UK model for operational separation provides a framework for separate financial statements and reporting by Openreach and BT Wholesale. These price related equivalence obligations are in addition to accounting separation, which may be applied under Ofcom's other powers.
19. While the Commerce Commission now has the power to determine accounting separation requirements, TelstraClear remains of the view that this will not fully address the absence of price related equivalence principles from the operational separation undertakings. These undertakings will only be effective if price and non-price safeguards are wired into the operational separation model in an integrated fashion, rather than applied under separate regulatory instruments each with their own focus and requirements.

Yours faithfully



Chris Abbott
Group Manager Regulatory