



31 March 2008

Backgrounder

Telecom Operational Separation

The Telecommunications Act 2001 sets out the main requirements for Telecom's operational separation:

- the establishment of at least three separate business units – a stand-alone, arms-length fixed network business network (referred to as the Access Network Services (ANS) unit in the Minister's Determination), one or more arms-length wholesale units, and one or more arms-length business units that provide one or more other functions (for example, retail services);
- the establishment of an independent oversight group; and
- transparency and equivalence of supply of relevant services and access to Telecom's network.

In addition to the requirements of the Act, the Minister's Determination, as amended in December 2007, comprises the following requirements for Telecom:

- A requirement to establish a separately branded, stand-alone ANS unit that will control all present and future access network assets, including fibre and wireless access assets. This will ensure broad and comprehensive service coverage, and ensure the unit is forward-looking and future-proofed.
- Generally speaking no Telecom employees are allowed access to ANS unit commercial or customer confidential information unless the service provider that provided that information consents.
- A requirement that any future commercial fibre-to-the-premises and access to the NGN core be provided on a non-discriminatory basis.
- A requirement for an arms-length wholesale division that will provide access to key fixed network regulated services, including advanced bitstream services to all service providers (including Telecom).
- A requirement that the definition of relevant wholesale services include IP interconnection, and Telecom to provide details of its future consultation programme with service providers regarding IP interconnection.
- A requirement that the key regulated services be supplied to an "Equivalence of Inputs" (EOI) standard, and that ANS services (including fibre and access to the NGN core) be developed to be "EOI ready" to underpin future non discriminatory access.
- A requirement for Telecom to develop all necessary EOI infrastructure and transition all its services to that infrastructure within a four-year window. Telecom may (and has) propose migration plans for its legacy services to EOI compliant networks within four years as an alternative.
- Strict governance and arms-length rules that enable the Telecom group to be managed consistently with a robust operational separation, including the ability for the Telecom CEO to direct units subject to transparency requirements.

- Formal oversight of Telecom's implementation and internal compliance by an Independent Oversight Group (IOG) backed up by Commerce Commission enforcement.
- A requirement for Telecom to meet key organisational change requirements by "separation day", which must be no later than 31 March 2008.

Questions and Answers

1. Is Telecom's separation plan robust?

Yes, Telecom's Separation Plan is compliant with the requirements set out in the Determination, as amended in December 2007, and it is considered more robust than the BT Separation Plan.

2. What difference does this make for New Zealand families?

As a result of the operational separation of Telecom and other regulatory measures currently underway, it is expected that competition will increase and telecommunications users throughout New Zealand will be able to access a wider range of new and improved broadband-based services.

Improved broadband will offer kiwi families new ways of connecting with people, the ability to strengthen communities, enhanced participation in the democratic process, and new opportunities by breaking down the barrier of distance.

3. What are the pluses for the economy?

The operational separation of Telecom is one of many regulatory measures introduced by the Telecommunications Amendment Act No 2 in December 2006, which will increase competition and encourage investment in New Zealand's telecommunications sector, resulting in greater availability of broadband services.

Broadband is seen as a key driver of productivity and innovation in knowledge based economies. A number of studies have been undertaken, most recently by the New Zealand Institute quantifying the potential benefits to the economy in billions of dollars.

4. Why is the government imposing operational separation on Telecom?

Operational separation has been required by Parliament via the amendment to the Telecommunications Act 2001, which sets out the purposes of operational separation:

- To promote competition in telecommunications markets for the long-term benefits of end-users of telecommunication services in New Zealand; and
- To require transparency, non-discrimination, and equivalence of supply in relation to certain telecommunications services; and
- To facilitate efficient investment in telecommunications infrastructure and services.

Separation will increase the transparency of Telecom's business operations, and remove or limit the incentives and ability of Telecom to engage in discriminatory behaviours that lessen, damage or exclude competition in downstream markets.

5. What is the timetable for implementation of Telecom's Separation Plan?

- 31 March 2008 – “Separation Day”, at which point Telecom’s Separation Plan becomes legally enforceable and the ANS unit (‘Chorus’) established and wholesale services realigned.
- 1 July 2008 – remaining organisational implementation requirements completed by Telecom and Independent Oversight Group (IOG) appointed.
- As soon as possible – Telecom migrates to self-consumption of LLU and UBA products and prices.
- 1 January 2009 – undertakings for IP Interconnection finalised.
- December 2009 – business-to-business gateways supporting equivalent business transactions to be completed by Telecom. All re-sale services meeting re-sale equivalence standard.
- By 2011 – all LLU and UBA services fully EOI compliant.

6. What is the rollout plan for broadband?

Telecom has committed to the accelerated rollout of fast broadband that will deliver advanced broadband services to all cities and towns with more than 500 lines by 2012. Telecom announced the details of its cabinetisation plans and investment of \$1.4 billion late last year. These plans have been built into the Separation Plan and in some circumstances extended. See question below for detailed list of milestone objectives.

7. What penalties will be imposed on Telecom for failure to comply with the finalised undertakings?

The Commerce Commission is able to take enforcement action in the High Court for each breach of the final separation undertakings by Telecom which could result in a pecuniary penalty of up to \$10 million for each breach, plus \$0.5 million per day for continuing breaches.

8. Will this be completed by 2012?

Yes. If Telecom does not meet the deadline, it will be subject to the penalties set out in the Telecommunications Act 2001 for failing to comply with the Separation Plan – up to \$10 million plus \$500,000 for each day the breach continues.

9. What is the difference between the BT Separation Plan and Telecom’s Separation Plan?

The Minister’s Determination was based closely on the Ofcom/BT requirements and undertakings. Any variations from the BT undertakings in Telecom’s Separation Plan have been necessary because of the vast difference in scale between Telecom NZ and BT and the different network environments.

10. How independent is Chorus?

Chorus is bound by the Separation Plan to operate on a stand-alone basis and at arm’s-length from all other Telecom business units. This will be closely monitored by the IOG and the Commerce Commission.

11. What will the levels of delegation be?

- ANS (Chorus): Manager (Mark Ratcliffe) reports direct to Dr Paul Reynolds, CEO Telecom New Zealand
- Wholesale: Manager (Matt Crockett) reports direct to Dr Paul Reynolds.
- Retail: not yet announced.
- Telecom Board: The Separation Plan does not limit the Board's power to act in the best interest of Telecom. However, if the Board wants a business unit to act in a way that is not in accordance with the undertakings, the Board must make the request in writing, give a copy to the IOG and the Commerce Commission, certifying that the direction is consistent with the robust operation of Telecom, and report to the Commerce Commission and the IOG on whether the direction undermines the Act.
- Independent Oversight Group (IOG): Telecom will establish an IOG consisting of five members. The Telecom Board will appoint the members of the IOG, with the majority of members being independent of Telecom. The Board will appoint one of the independent members of the IOG to be the Chairperson. The Board must adhere to strict guidelines when appointing the IOG, and must consult with the Commerce Commission on the appropriate skills mix for the IOG before appointing the chairperson and other independent members. Telecom will establish terms of reference for the IOG that provide for the monitoring and oversight functions outlined in the Separation Plan.
- Commerce Commission: in accordance with the Telecommunications Act, the Commerce Commission will monitor and enforce the Separation Plan. The Commission will also have the ability to be involved in Telecom's IP Interconnection consultation programme, in whatever role it chooses.
- The Minister for Communications and Information Technology: is able to change his Determination at any time. This would require Telecom to provide a new Separation Plan.

12. Apart from separation, what else is being achieved in the telecommunications regulatory area?

The government is committed to creating the conditions for competitive broadband and communications services (including mobile) for all New Zealanders, including those who live in rural and remote areas.

In 2006, the government announced a comprehensive telecommunications package. Implementation of this package is now well underway, and the government and telecommunications industry are working hard to implement these changes.

To date:

- A review is underway of Telecom's Kiwi Share obligations, including the updating of requirements to ensure the quality of all local service available is at least of a minimum grade.
- Options to encourage investment in broadband infrastructure, in both rural and urban areas, are being developed. At last year's Digital Future Summit, the Minister announced several policies that the government is considering to promote investment.
- Planned regulation of access services requiring the unbundling of the local loop and sub-loop copper-wire lines between telephone exchanges and homes and businesses, so alternative Internet Service Providers can compete fully with Telecom to provide faster, cheaper broadband. The Commerce Commission has issued its final determination on the standard terms and conditions for access to the unbundled local loop.

- Removing constraints on the existing regulated Unbundled Bitstream Service to enable alternative ISPs to offer broadband at upload speeds faster than 128kbps.
- Encouraging investment in alternative infrastructure such as fibre, wireless and satellite networks by measures including a review of public sector investment in telecommunications infrastructure to encourage a whole-of-government response.

13. What more is happening to improve telecommunications in New Zealand?

The government recognises the value that broadband brings to all New Zealanders. It is clear that there has been a history of under-investment both in rural telecommunications and in urban “black spots”, and the government is very concerned about the resulting lack of broadband capability in these areas.

The government is currently looking at ways of addressing these issues, with a focus on:

- urban fibre networks
- rural broadband
- international connection; and
- demand aggregation
- operational separation.

14. What changes have been made since the Minister declined to approve Telecom’s amended separation plan on 24 December 2007?

A significant number of drafting amendments have been made covering a wide range of issues, including:

- Reducing the level of group based incentives for Wholesale Division Managers to no more than 30 per cent of their total income
- Enhancing the milestones for NGN rollout to clarify expectations that fixed voice customer lines operation will reach the target of 84 per cent by the end of 2012. We will have achieved 10 Megabit per second and 89 per cent of lines will have achieved 5 Megabit per second.
- Strengthening provisions around IP interconnection to provide the strongest possible assurances of non-discrimination given the current level of technology uncertainty, and providing for a robust and transparent process for resolving any future definitional or access issues.
- Further protection of confidentiality for customer and commercial information, given the need to build additional safeguards into Telecom’s internal information systems and providing a role for the Commerce Commission in overseeing this process
- The number of other drafting and definitional changes to better give effect to the separation plan.

15. What other assurances have been received from Telecom in respect of separation related issues?

I have also received several important letters from the Chief Executive of Telecom NZ further underlining Telecom’s commitment to:

- Maintaining the integrity and confidentiality of commercial information and customer confidential information, including by providing for the Commerce Commission to proactively monitor and report information during that transition period
- Providing further commitments in respect of their telecommunications coverage to underline the expectation that no less than 84 per cent of lines will receive at least 10 megabit per second by 2012 and committing in principle to ensuring that Telecom's level of investment in Zone 4 rural lines "will not be less than (but may be greater than) the gross contributions that Telecom receives through the Telecommunications Service Obligations subsidy
- Openly and transparently accounting and expending future TSO compensation payments received by Telecom under the local service TSO agreement in zone 4 rural areas. Telecom's now committed to spending all TSO contributions from other companies on Capex in Zone 4 rural areas. Telecom has committed to use its best endeavours to do this by 30 June 2008 noting the crown's position that all TSO contributions be spent in these rural areas. Telecom understands it is the Crown's position that expenditure calculated for the purpose of the local service TSO should be spent in the relevant are. Telecom will use best endeavours to reach agreement with the Minister on the new TSO by 30 June 2008.
- Clarifying the relationship between Fixed Wireless Access, Mobile and Future Dual Use Technologies.
- A letter confirming T's commit to maintaining the integrity and confidentiality of customer information and commercial information during the transition period to the fully separated new systems required in the undertaking
- Telecom agreed to invite the Commerce Commission to carefully monitor information security during this transition period.

16. What are the requirements for operational separation based on?

The Determination, as amended in December 2007, is based on the Telecommunications Act's requirements and informed by:

- The model adopted in the United Kingdom for British Telecom (BT), which was identified by Cabinet as a useful basis for a robust operational separation. Subsequently there was extensive consultation with BT, OfCom, UK DTI and the EU Commission as well as broader international benchmarking.
- The government's consultation with the industry, other stakeholders and Telecom itself, particularly on the draft operational separation model in April 2007. The government's model was well-received by industry and other stakeholders.
- Engagement with Telecom on the development of a robust and workable operational separation model.

17. What is meant by equivalence of inputs (EOI)?

EOI is one of the cornerstones of operational separation as it removes the ability of Telecom to discriminate in favour of itself. It means that Telecom has to provide relevant regulated services at the same price, on the same technical and commercial terms, using the same operational support systems and process, to all market participants including itself. Telecom does not have to provide relevant non-regulated services to other providers other than on a voluntary basis, but if it chooses to do so it must be on a non-discriminatory basis.

18. What is being delivered in terms of Public Switched Telephone Network (PSTN)¹ migration?

- By 30 June 2010 – more than 1,500 distribution cabinets installed or equipped with ADSL2+ or equivalent DSL capability (e.g. VDSL capability) in Telecom's Zones 1,2 and 3 with DSLAMs installed and operational.
- By 31 December 2010 – more than 2,200 distribution cabinets installed or equipped with ADSL2+ or equivalent DSL capability (e.g. VDSL capability) in Telecom's Zones 1,2, and 3 with DSLAMs installed and operational.
- By 31 December 2011 – 99% of lines in Telecom's Zones 1, 2 & 3 (which equates to 80% of existing PSTN lines) engineered to have a maximum line loss of 60db measured at 1024kbps at the external termination point.

As a consequence of achieving the enforceable milestones in the PSTN migration plan as at 31 December 2011, Telecom expects there will be a significant improvement in broadband performance within the Local Access Network (LAN). In particular, the engineering design rules applied to the LAN as part of those enforceable milestones will mean that:

- 84% of all existing PSTN lines will be technically capable of 10Mbps or better within the LAN; and
- 89% of all existing PSTN lines will be technically capable of 5Mbps or better within the LAN.

Telecom has made a commitment in its Separation Plan to roll-out cabinetisation to improve local loop broadband speeds and PSTN telephone service migration to a next generation all IP network in lieu of a regulatory requirement to implement EOI for legacy services. Indications from Dr Paul Reynolds at the Digital Future Summit were that Telecom will strive to do more for rural customers outside the bounds of the undertakings.

19. Why have requirements for IP Interconnection been extended?

The area of IP interconnection is technically complex and standards in this area are still being developed. Consequently, in my Amending Determination I extended the period for finalising the undertakings in this one area to 1 January 2009. Since December and as a result of submissions and work by Telecom technical staff, Telecom has made a commitment to a detailed consultation process with other service providers and regulators. My Notice of Requirements required Telecom to amend its separation plan to introduce this greater level of undertaking.

20. How have wholesale incentives been handled?

The Separation Plan requires that the Head of the Wholesale's group incentive be less than 30% of total remuneration in any year, and that the group incentive be less than the total of all other incentive payments (which are related to Wholesale Unit performance). The undertakings also require that an employee who reports directly to the Head of the

¹ The **public switched telephone network (PSTN)** is New Zealand's network of public [circuit-switched telephone](#) networks. Originally a network of [fixed-line analogue](#) telephone systems, the PSTN is now almost entirely [digital](#), and now includes [mobile](#) as well as fixed telephones.

Wholesale unit and who is responsible for relevant services, must not receive a payment that relates to the performance of the group as a whole. These requirements will ensure that key managers incentives are aligned with non-discriminatory requirements.

21. What steps were taken to finalise the separation plan?

- The Ministry of Economic Development undertook research into separation models and Telecom's current operational model and proposed an initial operational separation model for Telecom. The Minister released the model for public comment and feedback on 5 April 2007. Twenty three submissions were received, and released publicly on 1 May 2007. This consultation document, along with industry views and comments received on it, informed the Minister's determination and provided the public and industry input at an early stage of development of the detailed requirements for operational separation.
- As part of its submission to government on the operational separation consultation paper, Telecom proposed a structural separation model. On 1 May 2007, the Minister invited comment on the Telecom proposal. Nineteen submissions were received on it.
- Part 2A of the Telecommunications Act 2001 sets out the process for the Minister of Communications to finalise a legally enforceable Separation Plan with Telecom. In accordance with the Act:
 - On 26 September 2007, the [Minister of Communications](#) made his [determination](#) of further requirements with which Telecom's operational separation plan must comply.
 - On 25 October 2007, the Minister of Communications received [Telecom's Draft Separation Plan](#).
 - For a period of 20 working days from 26 October 2007 to 23 November 2007, the Minister of Communications sought submissions on Telecom's Draft Separation Plan.
 - After the completion of the public consultation phase, Telecom was required to prepare an [Amended Separation Plan](#) and a summary of how (if at all) the Plan was amended as a result of public feedback. Telecom's Amended Separation Plan and related documents were received on 19 December 2007.
 - On 24 December 2007, the Minister of Communications and Information Technology released an [Amending Determination](#), updating his determination of requirements for Telecom's operational separation.
 - On 24 December 2007, the [Minister for Communications and Information Technology](#) called for public [submissions](#) on Telecom's Amended Separation Plan. Submissions were to take into account the Minister's Amending Determination. Submissions closed Friday, 25 January 2008.
 - On 28 February 2008, the [Minister for Communications and Information Technology](#) issued a [Notice of Requirements](#) setting out areas of Telecom's Amended Separation Plan that he wanted to be amended. Telecom had 15 working days, or until 25 March 2008, to resubmit its Amended Separation Plan. The plan was received on 25 March 2008.