



Wholesale

14 May 2010

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Commerce Commission
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Dear Rebekah

Resale Investigation – Follow-up to meeting with Telecom

You suggested that it would be helpful if we wrote, further to our 4th May meeting, to recap Telecom's position on resale regulation. This will help ensure the Commission has a clear understanding of our intentions for resale and the objectives we have for the Commission's current investigation.

This letter essentially follows the format of our presentation with emphasis on the sections where we outline our position, thoughts on improvements to the current arrangements and what this means for our resale customers. For simplicity I have used the same headings as our presentation.

1. The current situation

Under the 2001 Telecommunications Act (the 2001 Act) resale is capable of being regulated and the Commission has made three resale service determinations (all now expired), between 2003 and 2005. The determinations provided the basis for RSPL (residential) and DSPL (business) pricing for the supply of resale services to TelstraClear, together with review, audit and other terms that were agreed between Telecom Wholesale and TelstraClear. The services in RSPL and DSPL were extended to Wholesale's other resale customers on a commercial basis. Since the expiry of the three resale determinations, the DSPL/RSPL services have been supplied to all customers on commercial terms. In 2008 The Undertakings made active (ie not grandfathered) DSPL/RSPL services "relevant wholesale services" for the purpose of operational separation. The DSPL/RSPL services continued to be supplied on commercial terms but new resale equivalence and non discrimination obligations applied.

So even though the DSPL/RSPL services have been provided on a commercial basis for a long time, many remain within the scope of regulation. This means that a customer could, if it felt it had a good case, request that the Commission investigate and determine terms of supply, or the Commission may initiate a standard terms determination process itself.

2. Telecom's position

In February 2009 we asked that the Commission review the ongoing need for resale regulation. At that time we envisaged a complete removal of the regime. Since then we have given further thought to the future of resale from a Wholesale perspective and in the regulatory context. This has been informed by the submissions from Wholesale's customers.

Our preferred outcome from the Commission's investigation is a narrowing of the scope of the regulatory backstop for resale services. We believe that residential and business line rental (RLR and BLR) should remain within the scope of regulation; in addition, some form of regulatory backstop may also be appropriate for a few key smart phone services (we propose Call Minder, Permanent Toll Bar, DDI, and Caller Display). Most other active (i.e. not grandfathered) resale services may be replicated by service providers on a nationwide basis through the use of a



combination of UCLL and / or wholesale intermediate inputs. I outline the practical effects of these changes for the market and customers below.

This would necessitate two important changes. First, a narrowing of the four resale related designated access service descriptions within Schedule 1 of the Telecommunications Act to focus on the set of resold services mentioned above and second, a review by Telecom and TelstraClear of RSPL and DSPL to simplify the review and audit processes and reduce the number of service families (and price lines).

3. Wholesale's drivers

Wholesale is an arm's length business with its own profit and loss statement. Resale services make up a large proportion of Wholesale's revenues, are a key driver of overall performance and therefore have a significant impact on the financial performance and customer satisfaction incentive based remuneration received by all Wholesale staff. We have strong incentives to continue to offer the resale services our customers want.

However, we do want to simplify what have become complex and administratively burdensome processes around resale services – for Telecom and for customers. This is the primary driver for our request for change.

At the same time, at the principle level, we believe a roll-back of regulation is appropriate. The 2006 amendments to the 2001 Act and the Telecom's subsequent Undertakings fundamentally changed the regulatory and market landscape. The changes move the focus of competition along the value chain from resale to intermediate wholesale or UCLL inputs. The organisational changes brought about as a result of the Undertakings remove historic concerns about the incentives of Telecom Wholesale.

Despite this principle, Wholesale understands why customers value a regulatory backstop for some key resale services which at present lack take-up of alternative intermediate inputs, and is willing to see this backstop retained.

4. What this means

As noted above, our proposals would involve modifying some of the service descriptions in Schedule 1 of the Act and working with TelstraClear Ltd (and others) on improvements to DSPL and RSPL.

In practice this is likely to make little if any practical difference for customers in the short term. Outlined below is a description of the practical effect of the changes.

- i. For the services that retain a regulatory backstop:
 - a. Service is retained in DSPL/RSPL price list and therefore continues to be treated as a "relevant wholesale service" in the Undertakings
 - b. Quarterly DSPL / RSPL price adjustments continue (subject to possible discussion with TelstraClear Ltd and other customers about alternative processes which could allow less frequent price changes)
 - c. Existing wholesale service agreement (WSAs) would remain for the duration of the agreement
 - d. Commercial negotiation at the end of the term (with a regulatory backstop)



Within this category RLR and BLR make up >80% of resale revenues (accounting for <2% of price lines in DSPL and RSPL), and the key smartphone services make up >6% of revenues (accounting for <3% of price lines in DSPL and RSPL).

- ii. For the residual resale services we envisage the following arrangements:
 - a. Existing WSA terms continue for the duration of the agreement
 - b. Commercial negotiation at the end of the term (without a regulatory backstop)
 - c. Assuming the service has been removed from DSPL/RSPL (with the agreement of TelstraClear) it will cease to be a "relevant wholesale service" in the Undertakings.

This category contains very low or nil demand services and services that have been grandfathered for example legacy data and IP services (which already fall outside the scope of regulation). This category makes up 14% of revenues (accounting for >95% of price lines in DSPL and RSPL), much of which come from services that are already grandfathered.

We envisage no changes to the current practices for migrating from legacy services to UCLL and wholesale inputs, which involve extensive notice and consultation processes with customers, and which we believe Wholesale customers are satisfied with today.

5. Next steps

We gave the same presentation to our customers at the April 22 Dialogue session in Auckland (which the Commission attended) and again at the May 7 session in Wellington, and offered one to one meetings for those who had questions or concerns about the approach we were proposing. These discussions are now occurring. We have of course met with TelstraClear who has a central role in this process for historic reasons (any changes to DSPL/RSPL will need their agreement).

We intend to continue our customer engagement over the coming weeks to ensure customers are informed, understand our reasoning and have a chance to flag any concerns. We will use this customer feedback to further refine our own analysis in terms of the list of services, and possible commercial measures that might be necessary to allay any concerns.

We were keen to speak to you before your analysis was completed to ensure the Commission is clear on Telecom's position. Should you have questions on any of the material covered above please get in touch; otherwise, we look forward to receiving the Commission's draft report in June or July.

Please contact Brendan Dempsey (brendan.dempsey@telecom.co.nz) if you have any questions or would like to discuss any aspect of this letter.

Yours sincerely

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