



TRISTAN GILBERTSON
Group General Counsel

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Dr Ross Patterson
Telecommunications Commissioner
Commerce Commission
L 6, Vector Building
44 The Terrace
P O Box 2351
WELLINGTON

Dear Ross

Consultation on non-discrimination and EOI obligations – loyalty complaints

Thank you for the opportunity to be consulted on the Commission's preliminary views on the non-discrimination and EOI obligations under Telecom's Separation Undertakings, in the context of Vodafone's and Kordia's complaints about our Wholesale Loyalty offers.

My earlier letters of 8 September and 2 October set out substantial submissions that we trust have been helpful to the Commission, and will continue to be considered by it, to ensure that the Commission has sufficient regard to all material aspects of those submissions.

The focus of this submission is to respond to your initial views on the general interpretation of non-discrimination and EOI, as well as to provide further context to enhance guidance and clarifications from the Commission to promote future shared understandings. The substance of those two objectives is set out in the Appendices to this letter.

It is important that the Commission considers the implications of its final views for the loyalty offers and for all other potential commercial offers in the future. In particular, at a high level, we ask the Commission to consider these matters:

- Wholesale and Chorus are both set up to make their own Commercial Policy as if they were separate businesses in relation to their Relevant Services. Both are expected to be customer focussed, to make offers, and to contribute to competition in their own right. Differentiation and innovation is important to competition;
- Both business units are subject to non-discrimination and EOI obligations and will be bound by the same rules;
- The special context within which non-discrimination is used – an economic regulatory environment – establishes that clause 56 means that which reasonable persons informed as to that context would understand it to mean;
- Wholesale's loyalty offers were motivated by a need to respond to exchange-based competition in a market in which consumers, and many service providers, do not differentiate between provision of service from either cabinet or exchange;

- Wholesale's loyalty offers were made available to all – there was no term or condition that excluded any particular service provider; neither were they designed to benefit any particular service provider. Taken as a bundle, they were designed to meet the different requirements of like categories of customers with like offers to extend like benefits to all customers;
- Wholesale's loyalty offers were not designed for, neither did they in fact advantage in any way, internal customers over external customers (the key regulatory policy concern behind such regulatory design) – in fact, the offers were as "unacceptable" to Telecom Retail as to Vodafone and Kordia; and
- This is not a case in which only one or two large customers were able to take the offers. Vodafone and Kordia are large customers who have choices about whether to invest in UBA or UCLL – that is a commercial matter for them. TelstraClear, another large customer, is simply carrying on with its commercial business and choices.

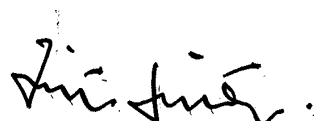
Telecom continues to use its best endeavours to comply with the Undertakings. Not everything in the Undertakings is clear and, in the absence of shared views, we simply need to do our best to comply on the basis of the information and advice we have available.

Telecom believes that its interpretation of the Undertakings applied in relation to non-discrimination and EOI is reasonable. We accept that there may be other views and judgements, and this has been clearly borne out through the IOG and the Commission processes. Upon receiving the IOG's view, Wholesale withdrew the offers pending the Commission's views.

It is important to Telecom and its customers that there is certainty in the regulatory regime and we are grateful that the Commission is sharing its views even in an investigation context. In a commercial world, there are many requests, needs, characteristics and requirements of customers that come in all shapes and sizes and these drive desires for differentiation in the market. Telecom clearly accepts that it is regulated, and is committed to operational separation principles, but it does need to understand at the outset how the Commission understands and intends to approach the rules. This promotes a constructive environment and we welcome your moves in this direction.

Finally, we note for completeness that the Commission refers to commencing two investigations – one under the Commission's discretionary monitoring and enforcement powers, and the other arising from the complaints. We are not aware of any investigation under the Commission's section 9A Telecommunications Act powers, and assume the Commission is referring to its powers under the Commerce Act.

Yours sincerely



Tristan Gilbertson
Group General Counsel

APPENDIX A

RESPONDING TO THE CONSULTATION DOCUMENT

The concept of “non-discrimination” was introduced into the New Zealand telecommunications framework by the December 2006 amendments that gave rise to section 69A of the Act. It is not defined in the Act. It was also not defined in the Minister’s determination or in the Undertakings.

Non-discrimination appears in the EU telecommunications regulatory regime and, consequently, in the UK regulatory regime. New Zealand’s Undertakings were modelled on BT’s Undertakings. Of course, a key difference from New Zealand is that the non-discrimination obligations on BT have been in place for many years, and are applied service by service following the market review process. Through the regulator’s detailed consultative market review processes, there has developed a shared understanding of the meaning of non-discrimination has developed over time, to provide the industry with the certainty it requires.

In New Zealand, non-discrimination has been applied through Separation Undertakings and to a wide range of Chorus and Wholesale services. This consultation document provides the first indication of the Commission’s approach to non-discrimination. The Commission’s views are interesting, and markedly distinct from those expressed by any other commentator (including the IOG, and Vodafone and Kordia) on clause 56’s meaning. Importantly, the consultation document highlights that Telecom could not have anticipated the Commission’s singular views, which demonstrates the need for, and benefit of, up front guidance.¹

From Telecom’s perspective, services are provided on a non-discriminatory basis if Telecom lacks the ability to choose which service provider may take up a service on its offered terms. The sense of non-discrimination is that Telecom bears the risk that any service offering may be taken up by any service provider. Like customers must be treated in a like manner. The Commission goes too far in extending that latter sense to require that any service offer be *equally commercially attractive* to any service provider. Every service offer will impact differently on service providers; there can be no single service offering that is equally acceptable to all service providers. The Commission’s own STDs differentiate between service providers. Non-discrimination is not intended to, and cannot in any meaningful sense, prevent differentiation between service providers.

We agree with the Commission that it should consider the ordinary meaning of the words of a deed. Dictionary definitions of “discrimination” and “provision” in connection with the non-discrimination obligation set out at clause 56.1 of the Undertakings are a good starting point.² The Commission is right, also, to dismiss the value-judgments inherent in some definitions of “discrimination”, and to recognise that non-discrimination is distinct from EOI. If it were not, non-discrimination need not exist at all. However, as we explain below, the special context within which the term is used – an economic regulatory environment – establishes that clause 56

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means that which reasonable persons informed as to that context would understand it to mean.

The risks with just a dictionary definition to ascribe meaning

The Commission's reasoning appears to leap from the dictionary definitions to conclude that "*any non-trivial **difference** in the provision of a Relevant Wholesale Service between service providers*" is discriminatory in terms of the Undertakings. The Commission appears to be reading in "non-trivial".³ Furthermore, the Commission suggests that any differences might be limited to "*technical, operational or a similar nature*" – such differences may or may not be "non-trivial".

The Commission's interpretation is also not consistent with its recognition that "*clause 56.2 does not provide any exceptions to the non-discrimination obligation*". The fact is that clause 56.2 is there expressly, for the avoidance of doubt, to permit "differences". If differences are permitted, without constituting an exception to the obligation, then the Commission's preliminary view that the obligation prohibits all "differences" cannot be correct.

To use the dictionary definitions just cited, the Commission should have parsed the prohibition as being of "*any non-trivial **distinction between service providers** in the provision of a Relevant Wholesale Service*". The Commission's preliminary view approaches the prohibition from the perspective of service providers – *ie*, a difference in the service provided between service providers. The prohibition is clearly intended to be read from Telecom's perspective. Correctly interpreted, the question is whether, in providing a Relevant Wholesale Service, Telecom distinguished between service providers. The "acceptability" of such an offer to service providers (or, indeed, to Telecom Retail, as the prohibition is also as between service providers and Telecom Retail) is not a relevant consideration – still less, the ultimate criterion.

The consultation reasoning similarly over-reaches on the scope of the prohibition. On the Commission's logic, there is no reason to stop at the planning or design of an offer. For example:

- Telecom Wholesale employs account and service delivery managers, who are responsible for Telecom Wholesale's relationship with its service provider customers. They are deployed in accordance with the customer's needs, including for Relevant Wholesale Services. A large complex customer relationship will incur greater service resource than a small simple relationship;
- Telecom provides services to its service provider customers on versions of Telecom's Wholesale Services Agreement. While all customers have the option to use the most recent template terms (which Wholesale considers to be the most customer friendly) there are presently three progressively developed templates still in use, the first two versions of which may additionally have been individualised in negotiations with a particular service provider; and
- Telecom is enhancing its performance reporting to service providers taking Resale Services. Larger service providers will have the reports split by business and residential metrics; smaller service providers tend to have little or no business component to their services, and thus will receive aggregated statistics.

³ This also goes to highlight the heart of the issue – different persons can take different judgments on degrees of differences that might or might not be permitted. The IOG, for example, moved 180° from defining discrimination as including an unjust or prejudicial component.

All that, on the Commission's logic, is Telecom doing something in respect of the provision of relevant services, but differently as between service providers.

The obvious sense of the non-discrimination obligation is that it bites on the "act of providing", and not earlier. Otherwise, anything Telecom Wholesale does – *eg*, meeting with one, but not another, service provider to discuss concerns about the performance of a Relevant Wholesale Services – is prospectively subject to the prohibition, which would be entirely unworkable. The "trivial" exclusion is not enough to sensibly limit this scope: the Commission surely would not suggest that business development discussions, fault reviews, and process improvement meetings with service providers are trivial. The lack of workability of the Commission's scope to the prohibition is illustrated by its characterisation of impermissible planning or design: the Commission impugns that on grounds of "intent", which the Commission previously – and correctly – identified as an irrelevant consideration in assessing discrimination.

Properly applied, the dictionary definitions support Telecom's case: to discriminate, in the present context, is *to distinguish between* service providers; that prohibition is in connection with *the act of providing* relevant services.

The application of dictionary definitions – giving meaning to individual words – does not by itself construe the relevant clause. Rather, clause 56 is to be construed by identifying the meaning the clause would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the time of entry into the Undertakings. Recourse to that background knowledge is not dependent on there being an ambiguity on the face of the Undertakings, but necessary in every instance to give the clause its ascribed meaning. The meaning of the clause is what the parties using those words against the relevant background would reasonably have been understood to mean.⁴

The regulatory context informs the ordinary meaning

The relevant background is not the to-and-fro of the parties' negotiations⁵, which – for reasons of public policy, whether or not the clause is ambiguous – are excluded from admission into evidence.⁶ Instead, the relevant background is the regulatory environment, in which robust operational separation was to be achieved in part by Telecom's arm's length wholesale operation, with an overriding non-discrimination obligation. In that regulatory setting, non-discrimination is a term of art. International precedent is of significant assistance: to disregard it is to fail to give due weight to the prohibition's genesis. As a regulatory concept, as we have previously explained, non-discrimination acknowledges that there may be differential treatment. We note that the recent discussion of non-discrimination in the New Zealand Government, Ultra-Fast Broadband Initiative, Invitation to Participate in Partner Selection Process also recognises this⁷:

Non-discrimination ensures that like Access Seekers are treated in a like manner, and that any differences are objectively justifiable by differences in costs, the Access Seeker's needs or the

⁴ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 (UKHL), 114-115 per Lord Hoffmann

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⁶ *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38 (1 July 2009), per Lord Hoffman

⁷ (October 2009), Appendix 4, clause 8

Access Seeker's characteristics. It is also essential that any differences in treatment do not harm competition.

The prohibition on discrimination was not intended to exclude objectively justifiable differences, as would, for example, permit discounts justified by the volume taken by any particular service provider. As we said previously, it is incomprehensible that – as a matter of policy – the Undertakings intended to exclude Telecom from (and therefore Wholesale's customers also – other service providers securing some aspect of their offerings to retail customers from Telecom, but without being able to access) the characteristic economies of scale and scope available to participants in telecommunications markets. The Commission's bald statement that "*the costs of supply by Telecom are not a relevant factor*" seems at odds with well understood and accepted economics and policy.

The prohibition's policy objective is domestically and internationally comprehended, as we previously identified, informing the parties' entry into the Undertakings. It anticipates that there may be objectively justifiable differences in Telecom's provision of services, without improperly distinguishing between service providers. That is the meaning to be ascribed to clause 56: it is, in short, that Telecom will not discriminate between service providers – that is, not distinguish between service providers – in the provision of any Relevant Wholesale Service.

Clause 56.1 cannot justifiably be read down by reference to clause 56.2. Clause 56.2 confirms that there may additionally be differences between service providers, on the basis of their requirements. Telecom does not rely on clause 56.2, but sees no reason to constrain service providers' choices to technical or operational requirements. The Commission later more correctly captures 'requirements' as 'needs'. The Commission has no foundation for its suggestion that Telecom could otherwise 'manufacture' justifications for differential pricing: if Telecom could not objectively establish clause 56.2's safe harbour, it would almost certainly run aground on clause 56.1's rocks.

Telecom's provision of any Relevant Wholesale Service may (on objectively justifiable grounds, including difference in costs or service providers' needs and characteristics) have differential application to any service provider. The prohibition is that, in making that provision, Telecom may not distinguish between service providers: any service provider qualifying for the offered service on the objectively justifiable grounds for difference is entitled to receive the service on those terms.

While we welcome the Commission's guidance on an ongoing basis, and there may be potential scope for it to play a constructive role, that is not through clause 1.2(b)(iii) which we read as relating only to exceptions from EOI. It is in relation to the much more restrictive EOI obligations that even objectively justifiable differences need to be, and can be, approved by the Commission.

The Commission's construction of the prohibition would render, for example, Telecom giving effect to UCLL STD pricing – where service providers are differently treated, depending on their location – a breach of clause 56. Similarly, Relevant Wholesale Services, to which clause 56 applies, include DSPL and RSPL services – eg, PSTN Homeline – pricing for which differentiates between service providers located in Auckland, Wellington and Christchurch and those located elsewhere in New Zealand.

In our view, the Commission's reasoning mistakenly attributes to the prohibition the more specific policy objective – "*to maintain incentives for progressing alternative*

infrastructure investment". Quite apart from the damage caused to that objective by UBA's retail minus pricing structure, as we have previously explained, it is clear that non-discrimination was not intended to do all the heavy lifting in attainment of that policy and can be starkly contrasted to the UK mechanism here referred to in our previous submission – such a mechanism was not put in place in New Zealand. The Commission's preliminary view mistakenly argues from, rather than to, a conclusion, and significantly overstates the obligation's impact as a result.

APPENDIX B

COMMERCIAL CONTEXT AND IMPLICATIONS

The importance of commercial context

We think it is critical that choices around interpretation of non-discrimination, December 2009 Requirements and EoI should be informed by the commercial context. In this Appendix, Telecom wishes to draw the Commission's attention to a range of scenarios featuring legitimate and pro-competitive differentiation. We want to ensure that any test emerging from the consultation process does not render these commercial constructs to be breaches. If they do, we think the outcomes will be adverse for end-users and, the tests should further developed to accommodate such activities.

Categories of difference

There are a range of differences that can be observed to feature in the current environment. In some cases, such differences are mandated in regulation. In other cases, but with similar considerations in mind, they are a product of commercial negotiation. Similar underlying services then can often be subject to differences in various metrics such as geography; volume or term; promotional activity; and a range of ancillary service options.

Non-discrimination

The Commission proposes that the non-discrimination obligation in clause 56.1 means that Telecom Wholesale and Chorus cannot for Relevant Services:

- Plan or design an offer that has the **intent** of treating service providers differently;
- Make an offer that has the **effect** of treating service providers differently; and
- Supply or deliver a service on different terms (including price) as between service providers.

The first two bullet points do not relate to any wording to that effect in clause 56 and, in any event, they become redundant by the third bullet point which equates non-discrimination with EOI. Telecom rejects categorically any attempt to re-construct the non-discrimination obligation in this way. If this reading is correct, these tests would rule out any differences of any kind. We assume this is not the intent. For example, various existing features of the regulatory regime include differential pricing, most notably:

- Provision of UCLL (and Naked UBA) on a geographically de-averaged urban/rural basis as per the UCLL and UBA STDs;
- Provision of resale services such as resold PSTN Homeline at different prices depending on whether service is provided in Auckland, Wellington, Christchurch, or elsewhere;
- The zone 1 and zone 2 distinction for resale; and
- Term discounts for resold ISDN BRA/PRA services.

These offerings all include “differences” that Telecom has never considered to be discriminatory, and we assume the Commission in its regulatory role shares that view. Presumably, the regulatory design reflects the section 18 objective of promoting competition for the long-term benefit of end-users. Arguably though, even though they are “open to all”, they will have the effect of treating different service providers differently. For example, different Service Providers have a range of skews in their respective retail customer bases across relevant geographical boundaries. In that context, the differences promulgated in the regulation inevitably have the effect of treating different service providers differently. Yet, they are in no real sense discriminatory.

Some existing commercial examples

Similar logic can be applied in a range of different circumstances across Telecom Wholesale’s commercial business. For example:

- Geographic distinctions give rise to different prices for HSNS and Point to Point Backhaul; and
- Term discounts apply for HSNS.

Telecom considers these existing structures to be pro-competitive and non-discriminatory. In particular:

- The geographic distinctions drawn in HSNS broadly map to the cost (and by implication the competitive) profile of access services;
- The term discounts for HSNS provide cost certainty for service providers through a period (and allow them to easily provide the often desired price certainty in the retail space). They also enable service providers to leverage the economic value of a committed revenue stream for the supplier in order to obtain a cheaper unit price. This structure also provides Telecom Wholesale with a degree of commercial assurance around an Ethernet based service in the face of the prospect of emerging next generation technologies.

Another, more anodyne, example (as discussed in Appendix A above) is the existing practice of providing resale services pursuant to different sets of general commercial terms as set out in the customer Wholesale Service Agreement or WSA for short (the price terms, service descriptions and core provisioning and assure processes are the same for all customers). These differences – which relate to “non-trivial” matters such as liability caps – reflect the incremental nature of negotiations over time. The fact that not every Service Provider has migrated voluntarily to “WSAIII” (which Telecom Wholesale considers to be the best option and which has been available to all customers to take up since before the non-discrimination obligation applied) reflects the differing commercial priorities or needs or requirements of service providers of many shapes and sizes. For some service providers, it seems it is simply not worth the time and effort migrating across to the new template. We think that these circumstances should not be considered to breach clause 56 by reason of either having “the effect of treating different service providers differently” or “delivering a service on different terms as between service providers”.

Some new ideas

Telecom is charged under the Act with being responsive to meeting its wholesale customers’ needs in relation to relevant services. We assume that clause 56 of the Undertakings was not intended to make this objective unachievable. Yet, we think that

would be the case if no differences were allowed. In particular, we have the view that, commercially, one size does not fit all. That fits with the Undertakings because it seems to us that the **lack of** different options is just as likely to be genuinely discriminatory. That is because a single, homogenous, undifferentiated offering will represent a composite set of commercial compromises that will invariably suit some more than others. That single offering will in fact treat different service providers differently. A suite of offerings has a much greater prospect of removing such bias and accordingly “meeting wholesale customers’ needs” in the manner that the Act contemplates.

For these and other reasons, Telecom Wholesale is considering a range of commercial innovations that it thinks have significant value from an end-user perspective. It expects that these concepts will resonate more with some service providers than others. They will be open to all, but unlikely to be taken up by all – and even if they are, they will again represent varying value propositions, largely dependent on the particular commercial circumstances of a service provider. We briefly discuss some of these ideas below.

Enhanced service level pack

Telecom Wholesale is currently piloting an option which allow service providers to pay additional fees to receive a “critical care” fault handling service. The providers for faults to be escalated and resolved as a matter of priority (without impacting on existing service levels). This is likely to be attractive to certain service providers that operate in premium niches of the retail market, for example where service variability is particularly risky from an end-user business perspective and can pass on the extra costs. Yet, for some service providers (such as those who operate solely in more cost-conscious market segments), this offering might have no utility whatsoever. The offer would be open to them, but as it would have no utility for them, they would not take it up.

Again, at that point, Telecom Wholesale would arguably be “delivering a service on different terms as between service providers”. If that is right, then this innovation simply cannot be delivered commercially as the additional fees are designed to fund additional resources to provide the service. From, Telecom Wholesale’s perspective, this counter-intuitive application of non-discrimination perversely causes discrimination to the extent that while the default terms are adequate to serve a certain category of service provider with a particular strategy, they are not adequate for a service provider with a different (arguably more innovative) strategy.

Tiered reporting regime

Telecom Wholesale is currently launching new service performance reporting for some relevant services. There will be no charge for the new reporting, but it is not the same for all service providers. In particular, Telecom Wholesale has classified service providers into two groups (Tiers A and B) based on volume of business. Tier A service providers will have the reports split by business and residential metrics; Tier B service providers will receive aggregated statistics.

Telecom Wholesale’s view is that the additional granularity will be of no value in the Tier B category because they have very low volumes of relevant business transactions. In that context, the Tier A splits will be meaningless. In these circumstances, Telecom Wholesale cannot justify the substantial extra cost. Again, though, we are concerned that this proposition may be interpreted by the Commission to breach clause 56 by “delivering a service on different terms as between service providers”. The only response for Telecom Wholesale at that point would be to remove the consumer/business splits in Tier A

to ensure compliance. This would clearly not be a competition or customer enhancing outcome.

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Dial-up to broadband promotion

To help stimulate growth in the broadband category, Telecom Wholesale might offer a lower UBA or UBS price on a national basis for a limited period. For example, there might be a three month window in which the service provider qualifies for a lower price point (for, say, one year) for any broadband connection churned from dial-up. This would arguably potentially skew UBA pricing in favour of those service providers with a substantial residual dial-up customer bases (assuming they could achieve a reasonable amount of churn to broadband). From Telecom Wholesale's perspective, such an offer on its face is competition enhancing and promotes category growth for the benefit of the whole industry. We would greatly appreciate any views of the Commission as to whether this would somehow constitute a breach of non-discrimination.

December 2009/EoI

Many of the issues raised above are relevant also to the December 2009 requirements and EoI context. The Commission states at paragraph 91 that:

... Telecom is not permitted to supply the service at a lower price to one group of service providers, and at another price to another group of service providers.

The difficulty revolves around the use of the word "group". Given the background of the loyalty offers, we assume the Commission sees UCLL providers and non-UCLL providers as different "groups". Does the potential for different levels of appeal to different "groups" mean Telecom Wholesale cannot:

- provide HSNS in a commercially appropriate form already finding resonance in the market?
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- Provide a UBA/PSTN bundle on a national or regional basis?
- Offer a dial-up to broadband promotion such as the one described above?

If so, again, we think the competitive environment will have been significantly harmed.