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Commentary on behalf of consumer interests on Commerce Commission paper dated 2 April 2015 as to TSLRIC and WACC uplifts

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1. Summary

1.1 This commentary raises concerns on behalf of consumer interests as to the current process, especially as to the TSLRIC and WACC uplift parts of the 2 April 2015 paper *"Agenda and topics for the conference on the UCLL and UBA pricing reviews".* It can be treated, if you wish, as an advance submission on that paper for which submissions are due by 6 May (and it will be followed by another later). Or it can be just a commentary, with the submissions to follow later.

1.2 In summary, it is submitted:

(a) Some developments in the 2 April paper are welcomed (for example, recognition that Chorus needs no investment incentives to meet its already contracted UFB commitments);

(b) But, primarily, consumer interests are alarmed and frustrated that, given the history including from the IPP, and the strong submissions and correspondence this year, the 2 April paper shows no signs of the Commission departing from its incorrect and unlawful approach, which is characterised by a repeated elevation of Chorus' interests (first reasonable investor expectations, then predictability, now price uplifts to increase fibre migration) above consumer interests. This submission firmly reflects consumer alarm and frustration. Consumer interests wish to avoid taking legal action to correct the process but if necessary will.

(c) It is clear from that paper, that the Commission is persisting in its approach of ignoring evidence and submissions, which must by law be taken into account. It is instead crafting a draft model that is hypothetical in nature when that is mostly contrary to the evidence and submissions.

(d) The 2 April paper signals that the Commission's future approach is unlikely to change on the current trajectory. We explain below why this can be deduced from this paper even though it is just a stepping stone toward the formal draft determination.

(e) It seems that no amount of submission and evidence, now so clearly given this year on top of what has gone before, will, on the current trajectory, change the Commission's path materially. Consumer interests are concerned and surprised that the 2 April paper was produced against that background, almost as though evidence and submissions did not exist.

(f) Only now, after over 2 years (1 of which the Commission took no steps) is the Commission moving to what consumer interests have asked for since and including the IPP: a quantified CBA.

(g) But this paper contains an assessment which remains far short of the real world evidence based quantitative CBA that is required by law. Multiple serious problems are identified below, but the great majority of those points are all set out in earlier submissions.

(h) Much of the submissions that are made, and the evidence given, are not particularly controversial and there are strong signs too that the Commission has an upwards pricing focus favouring, repeatedly, Chorus

and not consumers. Over time the multiple successive choices by the Commission give a strong perception of this.

(i) The perception is that, as one approach is found not to be viable, such as the prudent investor concept, another is put up in its place to justify sticking with original conclusions. Simple benchmarks show the draft pricing is well as out kilter and that further adds to the concerns (for example, Spark's Manhattan shows a far higher IPP and draft FPP UCLL price relative to comparator OECD countries).

(j) As one approach replaces another, the new approach fails to deal with evidence and submission. They even fail to deal with and contravene what two of the FPP Commissioners have stated in past proceedings. They said:

> "The purpose of the Act is to promote competition in telecommunications markets, not to promote take-up of a particular technology over another"

(k) The purpose of the Act is to promote competition, eg unbundling, and not to promote "take up of a particular technology over another" (AKA migration to fibre). Yet that is exactly what the Commission is not doing, and the Commission approach continues to ignore such observations and requirements with its narrow focus.

(l) The same two Commissioners also stated this:

> From the supply-side perspective, a low copper price (and hence lower profits from the copper network) could incentivise Chorus (which has secured ~70% of the UFB contracts) to roll-out fibre, and encourage customers to migrate to the UFB network more quickly.

(m) However, even as to the Commission's narrow focus on only migration to fibre, it did not mention at all the benefits to migration of lower prices

(n) Consumer interests are very concerned about this, when the Commission does not implement or consider what it has said in the past. This further gives the perception of apparent narrow and single-minded focus on upwardly moving Chorus pricing, to the detriment of consumers, for whom the Commission is guardian.

(o) If the Commission reviewed the submissions, they would find nothing new or unexpected in those observations.

(p) The Commission has made multiple modelling "draft" decisions, against the interests of consumers, under s18, on unlawful grounds (eg reasonable investor expectations, then predictability, and now this incorrect and impressionistic assessment of cost as against migration to fibre. Modelling decisions, having been made on earlier applications of s 18 (especially "prudent investor"), led to the basis on which TERA did its detailed work. The appearance is that each new iteration of a s 18 model is aimed at shoring up the original conclusions to avoid re-work and to keep to the same outcomes. In each it is as though the consumer is irrelevant; certainly that is the impression that is given.

(q) What this has meant is that key modelling decisions (eg ORC v historical cost for reusable assets) have been made upon unlawful grounds (namely s 18 considerations that are wrong) and will need to be revisited and remodelled as necessary.

(r) The Commission must now, as it is required to do by law, prepare a real world evidence based quantitative CBA. Consumers insist that the Commission, as its guardian, now fulfil its legal obligations and fix this promptly to fix the problems of the past. .

(s) It is not pleasant to frame these points so firmly but consumer interests have done as much as they can short of that and are driven to this.

(t) The Commission process failure is primarily responsible for this state of affairs, this would not have happened if consumer submissions were engaged with adequately (the points were made often), and consumers expect the Commission to remedy the position the problems its process failures have caused including going back to re-model fully as needed. That we are two years down the track is not a reason that will be accepted in these circumstances for problems not to be fixed.

(u) Consumers have repeatedly said that getting it right is far more important than speed.is, but the answer to them on the point, when deciding in favour of speed trumping getting it right, was a single unexplained sentence. Going forwards, consumer interests require better than this. While it is fortunate that the Commission now knows that the law requires it to engage in writing with submissions, it would have been better if the Commission had done this voluntarily; for starters, it would have uncovered errors in the first part of last year instead of now and in the new few months.: fortunately the law requires the Commission to do this given it has not done so voluntarily. It is unfortunate it comes to that when it should be otherwise.

(v) Despite consumers being the focus of the FPP under s18, they are marginalised throughout, whether in dealing with submissions or being heard at conferences. The 2 April 2015 paper strongly demonstrates this yet the primary stakeholders are the consumers not the telcos. The time has come for this to be fixed so they are no longer parties forced to be ineffectual wallflowers in this process. This has not been sorted for too long, despite submissions and concerns expressed multiple times, and the consumer interests expect their guardian, the Commission, to fix this.

(w) We refer the Commission in particular in that regard to the sections below on the “current position” and the “consumers’ perspective”. We also refer to the section on the conference and consumers’ expectations as to the conference in those sections.

(x) We first outline welcome changes, and at the end we set out suggested changes. We do not suggest specific time lines as consumer interests expect the Commission to now thoroughly re-evaluate its approach in this matter. There is too much at stake to do otherwise. But some specific issues are raised around specifics such as the CBA, one-off charges and the 30R review.

(y) Consumer interests will gladly work in with the Commission to make this more workable and to strongly support the work of the Commission, but

the Commission will need to move quite some distance from the current approach for that to happen.

2. Introduction

What this commentary is about

2.1 We are providing this commentary in advance of the conference as it raises what are, for consumers, very important concerns and issues, some of which are applicable to the conference.

2.2 We are focussing particularly on the TSLRIC part of the paper, reflecting that we consider the WACC uplift part of the paper takes a more "best practice" approach to iterative consultation, which is strongly supported. "Best Practice" in the sense of the process, for, as to the substantive issue (a) it is not agreed there can or should be an uplift and (b) like the TSLRIC uplift paper, the WACC paper only considers, without giving reasons, an uplift, when we expressly submitted that if there is an adjustment it should be downwards.

2.3 That omission, and the focus of the Commission's approach toward, mostly, only factors that increase price, is a concern raised in this commentary.

2.4 As the view is taken that the Commission is unlikely to change its current trajectory – a trajectory that is well outside simple benchmarks such as Spark's UCLL Manhattan - unless the law requires it to do so, the focus is on process and substantive issues where the law and the courts can intervene. It is unfortunate that this is the position that has been reached as it should be unnecessary. Noted however is that even on appeals limited to law, the Supreme Court TSO decision shows there can be detailed review of factual issues.

2.5 A primary aim of this commentary (and prior letters and submissions) is to assist the Commission to get the process and outcomes right, rather than litigating, fully informed as to the issues and parties' concerns. In this way, litigation risk on process issues (and on substantive issues) is greatly reduced. Our clients continue to wish to work with the Commission to achieve that objective.

2.6 Since preparing this commentary, the Commission has allowed submissions on the paper by 6 May. While welcome, that does not deal with most of the issues in this commentary. Indeed it is an example of an approach that ought be avoided. It is really a symptom of the underlying problems.

2.7 In any event, we want to give the Commission a clear reminder now that, for example, a sufficiently fulsome real world evidence based quantitative CBA is legally required, and the paper falls well short of that.In this way, the Commission can get an additional month to prepare the right CBA.

Focus of this commentary

2.8 As the focus of this commentary is on issues arising out of the paper in relation to uplifts, from a legal perspective:[1]

(a) It does not deal with the many other issues in submissions; and

[1] In any event, as we have submitted, the Supreme Court decision shows that intensely factual issues in this area can constitute appealable errors of law. That expands appealable and reviewable issues

(b) The primary submission as to s 18 is that it has only limited application on the FPP (save as to backdating where it dominates), and only rarely has relevance to the Commission's task (which is to determine, in the Commission's words, the "true TSLRIC", which is an issue of determining cost only).

2.9 We particularly wish to emphasise this focus as issues such as around a quantitative CBA and s 18 are secondary to the main FPP issues by a substantial margin. The great majority of decisions in this process – outside backdating – are to be made without a s 18 analysis: to do the latter is contrary to the Commission's legal obligation, which is to determine, in the Commission's words, the "true" TSLRIC and not to determine a different price that it considers would better meet consumer welfare for non-cost reasons eg to get the benefit of fibre via migration.

2.10 Additionally, as we have submitted, the need to have a real world evidence based analysis applies beyond s 18 analysis.

3. Welcome developments

3.1 A number of changes reflected in the 2 April 2015 "Agenda and topics for the conference on the UCLL and UBA pricing reviews" paper are welcomed, particularly:

(a) The move to undertake a more quantified empirical analysis of whether an uplift in UBA and UCLL WACC and/or UCLL TSLRIC prices is warranted (although we submit below the paper sets out a TSLRIC uplift analysis which is short of what the law requires by a considerable margin);[2]

(b) The analysis will be based on consumer welfare not total welfare;[3]

(c) Further, the focus is on the benefits and costs to consumers of New Zealand telecommunications services;[4]

(d) Recognition that parties have submitted that what was called a "central estimate" in fact was not a central estimate (implying this will be revisited);[5]

(e) Recognition that uplift for either investment or migration reasons would impact on the other and this interlinkage would need to be taken into account;[6]

(f) The focus is on incremental costs and benefits e.g. the deployment of the UFB is contractually committed and therefore the majority of these benefits are likely to emerge irrespective of whether an uplift;[7]

(g) The illustration that migration benefits (if any) from an uplift in UCLL, even if they are assumed to be very high,[8] will be substantially outweighed by

[2] [39] in the 2 April paper
[3] [34] in the 2 April paper
[4] [46] in the 2 April paper
[5] [29] in the 2 April paper
[6] [32] and [33] in the 2 April paper
[7] [42] in the 2 April paper
[8] 25% of the build cost of the UFB network based on the Commission's modelling assumptions.

the detriment from higher prices (at approximately a 5:1 ratio, based on the Commission's modelling);

(h) Recognition that the benefits from uplift could be reduced by a number of factors including:

(i) the potential for retail prices for UFB-based services to increase in response to any increase in retail prices for DSL services;

(ii) negative externalities for the subscribers remaining on copper-based services;

(iii) supply-side constraints in connecting UFB customers; and

(iv) additional welfare losses for those individual subscribers who switch to fibre in response to the higher copper price.[9,10]

(i) Providing a draft methodology as to WACC, to be followed by a pre-statutory draft determination updated modelling (we hope that will be followed by pre-statutory draft determination consultation).[11]

3.2 There are two further developments that it is hoped are positive.

"Predictability" is gone

3.3 First, the discussion on uplift of TSLRIC and WACC makes no reference to "predictability", and instead focuses on quantified CBA. It is our hope that this reflects an implicit acceptance that the "predictability" approach has been rejected and is to be replaced by the quantified CBA approach whenever s 18 is applied. The quantified CBA approach would apply, for example:

(a) Additionally, whenever the Commission applies s 18 other than in a final mop up s 18 adjustment.

(b) That includes as to the decision on backdating (which is dominated by s 18, assuming however the Commission does not accept our primary submission: that the Commission has no power to backdate).

(c) It also includes whenever the Commission applies s 18 during the pricing process prior to the wrap-up. We have submitted that s 18 has incorrectly been applied when deciding issues such as ORC v historical cost for re-usable assets (and the other s 18 choices feeding into the "central estimate" such as those at [7.11] of our February submission). But if s 18 does have a role during the process, the same approach to its application is to be taken as in the wrap up which is dealt with in the 2 April paper.

Spreadsheet shows no reason to uplift anyway

3.4 Second, even on the overly generous assumptions, as outlined below – such as the assumption that migration benefits are 25% of UFB build cost, cross-elasticity is 1.2, there is 100% pass through and no fibre retail price movement, the spreadsheet shows benefits of only around $19M over 15 years, compared

[9] [70] in the 2 April paper
[10] It is unclear why the Commerce Commission has not attempted to quantify these factors. They would mostly be straightforward to quantify e.g. scale down the migration benefits by the percentage of customers that do not have access to fibre.
[11] [92] in the 2 April paper

to $94m in detriments through higher prices to consumers. This highlights that end-users face a trade-off between the clear and certain detriment of price increases versus uncertain migration benefits that only marginally compensate for the price increases. The benefit is within rounding error and confirms there should be no uplift (nor upwards biased s 18 decisions in other areas such as earlier modelling decisions and backdating).

3.5 The Commission, it is submitted, has incorrectly applied the effects of earlier adoption, to have a full CBA up to 2029. The Cambini point, correctly applied, is that earlier migration in the 5 year period to be regulated, leads to welfare benefits after the 5 year period. Critically, only those incremental benefits are to be modelled, and not the full CBA until 2029, assuming current pricing. Prices after the 5 year period are to be decided later and a full CBA for then is irrelevant (and taking it into account is an error of law) e.g. any benefits from UCLL uplift after 2019 are an incremental benefit from a decision on post-2019 pricing and not a benefit of 2015-2019 pricing.

3.6 What can be taken into account (incremental impact beyond the 5 year period) is likely to be modest.

3.7 To start, however, the benefits in the spreadsheet for only the 5 years reduces from around $19M to around $5M when the next 10 years are removed.

4. Strong support for an iterative but best practice approach

4.1 Comparing the WACC uplift part of the paper with the TSLRIC part of the paper:

(a) valuably demonstrates the key concern in this commentary; and

(b) demonstrates the strength of a best practice approach (which is more like the WACC uplift paper) relative to a poorer approach (the TSLRIC uplift paper).

4.2 If the Commission moved to the best practice approach, including engaging in writing with parties' submissions in draft and final determinations (and, often, in other drafts and papers too) that will allay many of the long standing concerns of our clients.

4.3 As we have submitted a number of times, an iterative approach is valuable and strongly supported. But the trick is in how it is done.

4.4 The sort of approach in the TSLRIC uplift part of the paper has been a source of considerable concern to our clients in the past and the 2 April paper continues this. It in fact heightens those concerns as it is submitted that largely the same practices continue despite submissions. We explain this below.

4.5 While our clients would not agree with all matters raised in WACC uplift part of the paper and it has some deficiencies (eg it fails to deal with a key submissions), it is approaching best practice in that it is open textured, and provides a platform for review and debate about modelling choices. Of especial value is that it does not, contrary to the TSLRIC uplift paper, limit itself to facts and positions. It shows that the Commission is open minded about matters to be raised.

4.6 It also has the advantage of freeing up an iterative approach by being less likely to send unhelpful messages to RSPs, Chorus and investors.

5. Focus of this commentary is on the TSLRIC uplift

5.1 While there are some observations below on aspects of the paper dealing with WACC, the focus of this commentary is on the TSLRIC uplift part of the paper. When we refer to "the paper" below, we refer only to the TSLRIC analysis, as we deal with WACC separately at the end.

5.2 The paper states as to the TSLRIC uplift, that:

(a) the analysis is limited to encouraging migration to fibre, relative to the direct impact of higher prices on end-users;

(b) the focus is limited to increasing only UCLL prices, rather than UBA or a combination of UCLL and UBA prices (and therefore, we submit that, without giving reasons beyond a single incorrect reason noted below, it will deal neither with UBA changes nor the prospect of reducing the price);

(c) it has been prepared taking into account all submissions and cross-submissions[12] (and therefore, it is submitted, this is the Commission's draft position having regard to those submissions). The paper states:[13]

> "This section sets out a framework for considering whether an uplift should be added to the TSLRIC price for the UCLL service…..In developing this framework, we have taken account of the views expressed by parties in their submissions and cross submissions on the draft determination".

5.3 That last quote underpins the biggest concerns here, as outlined below.

6. A major concern about the TSLRIC uplift paper

6.1 In this section, we explain the implications of the paper, including legal implications, taking into account that the paper is just a step in the process, and there is no statutory duty to give reasons. While the duty to engage with reasons in writing is not the same as in a draft statutory determination, conclusions can already be drawn. And, in any event, the trajectory of the Commission can be deduced, as to the likely approach in statutory draft determination when reasons must be given.

6.2 A big concern, which is so by a substantial margin, is that:

(a) the Commission, self-evidently, is making draft decisions without regard to key submissions and evidence; and/or

(b) it is showing that it is making decisions that would be, it is submitted, in error of law;

[12] As stated at [36] in the 2 April paper
[13] At [35] and [36]

(c) this emerges from the approach in the paper when the Commission has stated that it has taken into account all submissions and cross-submissions in deciding its draft approach;

(d) implicit are process and substantive legal errors in addition to what has been raised;

(e) more significantly, the concerns raised earlier have mostly not been addressed, implying that is likely to remain the position going forward; and

(f) this is happening when the Commission is producing its third iteration and major variation of its s 18 analysis ((a) reasonable investor expectations then (b) predictability then (c) quantified CBA based on retail cost v migration to fibre).

6.3 At this stage, we cannot be sure on all points, given that detail is not given as yet, as to whether there is a process error ((a) above) or an error as to a substantive matter ((b) above).

6.4 That is one reason why we cannot give final advice to our clients on the full legal position until the draft statutory determination is produced. While it seems likely in our view that there are process and/or substantive legal errors, exactly what cannot be assessed yet. But what is apparent is that this process is heading more down a path that constitutes error of law (as to process and as to substantive error) than we earlier submitted, whatever the legal position in the Commission's paper.

History

6.5 A particularly important consideration for our clients is that the problems they perceive, back to and including the UBA IPP process, are continuing despite strong submissions seeking change. It was hoped that this time this would be dealt with.

6.6 The perception is that submissions and evidence continue to be ignored. There are multiple examples that can be given. Papers such as this generally end up in final decisions with an approach reflecting no reference to those submissions and evidence. Essentially the course tends to be broadly set. Thus, there is no sign that the legal obligation to engage with submissions in writing will be met in the statutory drafts: to the contrary. Essentially this paper establishes the position for the draft subject only to change following submissions: changes that generally in the past have not dealt with the submissions and evidence of our clients. Again, there are multiple examples of this.

6.7 The perception is that this is not just omission in the sense that the Commission has decided against the submission after careful consideration, but it simply has not recorded that. The perception is that the Commission has not engaged sufficiently with the submissions and the evidence.

6.8 It is to be hoped that the Commission does not dismiss these concerns too lightly, for they are strongly held concerns that have developed over some time. It is also hoped that they will not be dismissed on the view that clients are simply not accepting correct decisions against them.

6.9 This is one of the reasons why the legal obligation to engage with reasons is pursued so strongly on behalf of our clients. Given the history, it is largely the

only way in which they can achieve ensuring that their submissions and evidence are engaged with.

6.10 Which is unfortunate when it comes to that as that should never be the focus, ideally.

The practical position

6.11 Whatever the legal position, the Commission would reduce those concerns markedly if it also engaged in writing with the submissions and evidence in papers such as the TSLRIC uplift paper. It has to do it at some point anyway so it is better to do so up front. For example, it might as well test its modelling and approach as against submissions and evidence early on, rather than leave that until the draft determination, when it might have to then change course.

6.12 To do so also would reassure our clients, where a decision has gone against them, that at least it has been considered (instead of being left with the sense, as often happens, that the issue has not been dealt with).

6.13 To do so will also speed matters up. The TSLRIC uplift model cannot survive legally and will need to be replaced. If the Commission engaged in writing with submissions in relation to papers such as the 2 April paper, it will likely get to the right position much more quickly.

Focus

6.14 The main focus below is on examples (out of numerous more issues arising out of the paper) where legal submissions and evidence have been provided that are contrary to the paper and not dealt with in the paper. Those are legal process and substantive issues.

6.15 We turn now to those examples we are raising, starting with absence of quantitative CBA.

7. Commission's obligation to do a sufficiently fulsome real world evidence-based empirical analysis

7.1 We have submitted that the law requires such analysis multiple times since and including submissions leading up to the IPP determination, most recently via a short summary in our letter of 13 March 2015.

7.2 At no point has the Commission engaged with those submissions in writing, despite legal obligation to do so, at least in the draft and final determinations.[14]

7.3 Over two years after the UCLL FPP review was commenced, including nearly a full year during which the Commission took little or no action on the FPP, the Commission has just moved toward preparing such an analysis for the first time.

7.4 It is submitted that the analysis in the paper falls considerably short of what is legally required. It cannot reliably be called a quantitative CBA, and, beyond analysing increased payments by UCLFS, UBA and UCLL–based retail customers, continues to be impressionistic (that is, it could not be described as legally acceptable even in a qualitative sense, assuming no quantification is possible).

[14] As the Commission believed the December draft to be a statutory draft, and it did not deal with this submission, that has happened in this FPP too. In any event it did not engage in the IPP draft and final determinations.

7.5 To describe the 25% for externality uplift as "qualitative" when it is largely a guess would be erroneous as there are, simply, no grounds on which to make such a guess. "Impressionistic" – the sort of thing for which the High Court criticised the Commission for in the IM Merit Appeal as we have submitted – is more accurate for this type of guess.

7.6 Likewise the spreadsheet assumes that an increase in UCLL prices would have no impact on UFB retail prices, despite the paper acknowledging it could, and despite submissions providing evidence to the contrary. This is a critical assumption. Loosening it could result in elimination of most or all of the estimated migration benefits from higher UCLL prices, and could result in a conclusion that lower UCLL prices (not higher) would result in greater migration benefits.

7.7 This is so at a high level, and is also illustrated by the detailed examples below, which demonstrate this is not compliant.

High level - benchmarks

7.8 There are benchmarks we can show a court to provide a simple comparison, to demonstrate how far the paper (and any evolved variation) falls short of what is required. In terms of benchmarks, the paper is well short of the Part 4 quantitative analysis on WACC percentiles. As summarised in our 13 March letter, it is submitted a court would not permit such disparity.

7.9 A fine benchmark is the Vertigan committee CBA in October 2014[15] provided for the Department of Communications in Australia.

7.10 It is submitted that it is surprising that the Commission makes no reference to this most relevant quantitative CBA.

7.11 As a benchmark, this is a far more comprehensive analysis, from our nearest neighbour, than the rudimentary TSLRIC uplift analysis on an overlapping issue.

7.12 This included quantification, in the context of comparing NGN options, as to the very issues that the Commission (and Professor Cambini) maintain are not quantifiable. The report was even able to do three separate quantitative analyses based on the evidence to arrive at a corroborated conclusion as to externalities and as to willingness to pay: a conclusion that, by the way, strongly points to low externalities. The Vertigan report shows that the Commission can do a similar analysis.

7.13 We return to more detailed issues below, where the paper does not deal with submissions and evidence.

What's at stake?

7.14 Clearly the sums involved require a comprehensive approach to the CBA, benchmarked, say, against the Vertigan and Part 4 reports. This is not, say, an issue involving $1M where corners can be cut. On the Commission's figures (Table 5 of the paper), consumers end up paying an additional $94M for every

[15] *Independent cost-benefit analysis of broadband and review of regulation: Volume II – The costs and benefits of high-speed broadband, August 2014*. The Vertigan report also highlights that the Commission is incorrect that Ofcom's 2004 statement on mobile termination rates is the only example where a regulator has attempted to determine the value of a network externality in a telecommunications context.

$1 uplift in copper price over the 5 year regulatory period[16]. $94M alone is big, but the range of possible dollars uplift is significantly larger.

Digital divide

7.15 On the Commission's figures, around a third of the $94M per $1 is paid for by customers that take UCLFS-based services without broadband. They pay more with no material countervailing benefit. They are typically rural or low income, which is a digital divide issue.

8. Section 18 analysis

8.1 This is our second point.

Background

8.2 The section 18 analysis thus far – particularly largely linear and single reliance on "reasonable investor expectations" and then "predictability" – with all the flaws submitted by the parties – has dominated many of the Commission's major modelling choices. A great deal of work has been done by TERA and the Commission (and, therefore, the parties), flowing from those multiple choices o big ticket items such as choosing ORC instead of historical cost for reusable assets (where the central estimate choices were made, relying on s 18, contrary to what the draft states).

8.3 This has happened all the time without the evidence based empirical analysis that the Commission was, it is submitted, required to do by law from the outset. Thus, the choices and decisions have been made without legally required evidence and analysis.[17] We return below to the implications of this but we note now that what flows from this is a need to revisit all s 18 based decisions when the full CBA is completed as different answers are likely.

8.4 For the reasons in this commentary, the paper shows little relevant change toward a fulsome CBA, away from the previous impressionistic approach. For example, it retains a focus on only a small sliver of a proper welfare analysis.

Section 18 – a major change of approach?

8.5 Unless the messaging differs due only to trimming down of the paper relative to the December draft decision, the paper signals a major change to applying s 18 from the December draft, which is contrary to that draft, contrary to submissions by us and others, and, in our submission, contrary to law.

8.6 In the December draft decision, the Commission accepted that, in summary, s 18 can only be applied within the TSLRIC objectives of deriving the efficient costs, a conclusion it must come to due to the words of the Act and also the Court of Appeal decision in *Chorus*. We summarised the Commission's position at [5] of our February submission, and we suggested a number of refinements, especially as to clarity around the steps being taken. We still think our submission will help get clarity of approach.

8.7 But on its face, the s 18 uplift assessment is now separate from the TSLRIC exercise, as a subsequent standalone step. For example, this footnote in the

[16] The cost is even higher if the calculation goes beyond the 5 year period as in Table 5, to cover 15 years, but as we explain below the approach is in error when going in this way beyond the 5 years.
[17] Even assuming s 18 can be taken into account at these points, contrary to our primary submission

paper indicates that a s 18 uplift is to be a standalone exercise, independent of the TSLRIC assessment (highlighting added):[18]

> "In the analysis below, the Commission is interested in identifying the **benefits and costs to end users of a given uplift** to the UCLL TSLRIC price, rather than attempting to derive an **efficient uplift**."

8.8 It is a little hard to work out what "efficient uplift" refers to, highlighting how important it is to be clear about the words, especially where, as we explain at [5] of the February submission, "efficient" is different within a TSLRIC cost exercise (what is the most efficient/cheapest network?) from a consumer welfare "efficiency" analysis, in the sense of static and dynamic efficiencies. There is and can be confusion.

8.9 However, it seems likely (in fact it is hard to see a different explanation) that "efficient uplift" refers to "efficient" in the sense of the cost of the HEO's network, and "the benefits and costs to end users of a given uplift to the UCLL TSLRIC price" refers to welfare analysis under s 18.

8.10 This implies there can be a consumer welfare based uplift on price independently of TSLRIC cost considerations. That is a radical departure.

8.11 If that is not what is intended, this points to the need to be very clear in the approach (as we have submitted; see for example [5.13] to [5.28] of our February submission). If it is in fact intended, that will be firmly opposed, it being submitted that it is not a legally available option.

8.12 As we said at [5.2] of our February submission:

> The objective is to determine the most accurate TSLRIC cost (and therefore price). This is what the Commission describes as the "true TSLRIC" derived by obtaining what it calls a "central estimate" of TSLRIC.[19] Using s18 distorts that objective".

9. The analysis must be based on real world evidence

CEG and Wigley submissions on the need for real world evidence

9.1 In our cross-submission at [9], we agreed with CEG that the s 18 analysis must be based on real world evidence, and not a hypothetical analysis. We both agree that the Commission needs to carefully distinguish:

(a) the hypothetical nature of deriving the cost of the hypothetical network operator; and

(b) The real world evidential requirements of the consumer welfare analysis for s18.

9.2 In CEG's own words:[20]

> "We consider that analysis of whether an uplift is required must be grounded in real world outcomes and not the world of the Commission's HEO. This has important consequences for how the Commission should

[18] Footnote 15. See also [28] and [29] in the paper.
[19] The footnote reads
"See for example [425] of the draft UCLL determination"
[20] CEG submission on Price uplifts February 2015 [11]-[14]

> consider the effect of the cost of capital and, more generally, the prices set for UCLL and UBA."
>
> "Our interest in performing this exercise is the effect of real pricing outcomes on overall welfare in New Zealand in which Chorus provides UCLL and UBA services and attempting to maximise benefits for that society."
>
> "We do not consider that the need to focus on real world outcomes in considering the need for an uplift is internally inconsistent with the Commission's framework for estimating TSLRIC through the prism of the HEO. The HEO framework does not negate the absolute requirement for welfare analysis to be undertaken in the real world."

How the Commission's paper handles real world evidence

9.3 In multiple places in the paper, the Commission does not deal with real world evidence in the submissions and cross-submissions. There are multiple places where other real world evidence is available as well, including where that is pointed to by submissions.

9.4 Generally, instead of real evidence, the paper relies upon more hypothetical conclusions – the sort of thing the High Court criticised the Commission for in the IMs Merit Appeal decision. It also relies on academic studies from overseas without regard to New Zealand real world evidence: we explained why this cannot happen at [8] of our cross submissions, including as to the way in which academic studies can be relevant. None of this is dealt with in the paper.

9.5 Some simpler examples of where the Commission has not used real world evidence in the submissions are now set out here

10. Movement in fibre-based retail prices

10.1 It is assumed in the paper that the fibre retail price would not go up as the copper based retail prices go up. We recognise and welcome that the Commission notes in effect this may need to be revisited. That is not at all a surprising point as it must be inevitable, as we strongly submitted, that fibre retail prices are affected by copper retail prices, even if not in linear fashion, and that is so despite price/quality caps on specified UFB services. Hence, it is of concern that the Commission would start with a hypothetical conclusion, contrary to submissions, and contrary to the evidence in the submissions, outlined below.

10.2 In fact the very regulatory structure is designed to keep fibre retail prices down, as Chorus's own expert, Dr Patterson, has said before he started advising them:[21]

> "The New Zealand policy is that copper will be a competitive constraint on fibre, with uptake determined by market forces. If copper prices are set above cost to encourage fibre uptake, they will no longer constrain fibre prices, and uptake will no longer be market driven."

10.3 We note that the paper does not at all reflect our submissions on this point, which is of concern. Submissions for example that the scheme and effect of the

[21] http://www.stuff.co.nz/business/opinion-analysis/8058701/Government-interference-doomed

Act, in context is, as Dr Patterson points out, to place a competitive constraint on fibre: therefore, increasing copper prices is contrary to the Act.

10.4 Then there is the evidence point. The submissions contain the best real world evidence so far. They say that when Vodafone lifted their copper based retail prices earlier this year, Vodafone equally lifted their fibre-based retail prices. We summarized this at [9.15] of our March cross submission.

10.5 They also say that, last year, in response to copper pressure, Chorus and the LFCs effectively reduced price by increasing speeds for the same price point.

10.6 That is the best real world evidence. Yes, analysis is needed to see what may happen over the 5 year period which may require further evidence (and academic studies might have some, limited, supportive relevance in that regard). But clearly the starting point in the paper had to be the real world evidence given to the Commission. And it is strong evidence that the hypothetical is simply wrong.

10.7 But it is ignored.

10.8 That starting point based on best available real world evidence would lead to a very different approach in the paper and a very different modeling approach.

10.9 This is a clear example of consumers' concerns as to approach since and including the IPP. The Commission has made hypothetical assumptions even when the evidence is there, and that is the very thing the IM judgment said could not happen, as we have submitted.

Conclusions

10.10 This leads to the following conclusions:

(a) A first interpretation. The Commission says it has taken into account all the submissions and cross submissions. Thus, the Commission has not accepted the submission by both us and by Chorus' expert that, in CEG's words, the "analysis of whether an uplift is required must be grounded in real world outcomes". Not referring to and relying on that evidence confirms that the Commission is not taking the real world evidence approach submitted by CEG and us, as that would be the pivot for the approach. Additionally, on this first interpretation, the Commission has rejected the submission that the Act does not permit the uplift as that is contrary to copper being a competitive constraint on fibre.

(b) That would raise a process and substantive law issue if this continues to the draft determination, if not already.

(c) Or a second interpretation: there is the actuality or perception that the Commission has not taken into account parties' evidence and submissions in preparing the paper. If that is so, it is ultimately dealt with when the Commission does what is required in the draft statutory determination when dealing with our and the CEG submissions on the point – engaging in writing with submissions - for this is an issue that can be appealed, as cases such as the IM judgment and the Supreme Court TSO case show.

(d) The perception over the years is that the latter is more likely.

(e) In the past there is a perception that such concerns would generally not be remedied as between drafts such as this, and the draft and final statutory determinations. In the section below as to consumers, we outline the practical implications of that.

(f) All this points to the strong desirability of taking the sort of approach, at a draft level, in papers such as this, which would be taken in the statutory draft. If the decision is indeed correct, then at least the reasoning will show that to be so. This can be done in steps, such as is happening in the WACC draft, so the Commission does not have to fully work up the analysis at every stage. It can be done in a manner that is manageable. But, ultimately, full reasons need to be given in the statutory draft; as it has to be done anyway, it would be better to do it sooner.

(g) Put another way, in pulling together a discussion paper (at least one as closed and decisive as this at draft level, relative to say the WACC paper), the Commission should prepare it now to be defensible in final form (the draft and final determinations).

11. Consumer welfare benefits from migration to fibre are assumed

11.1 The only material relied upon are the cross-elasticity conclusions from overseas academic studies (plus the guess as to externalities). As above, the Commission is required to pivot the analysis around real world evidence so far as possible. The hypothetical approach, albeit supported by some overseas material, cannot legally be used.

11.2 The Vertigan report noted above shows that the Commission can do a real world analysis, and can quantify this in a New Zealand environment. What that report shows is that a proper analysis is likely to show little consumer net benefit and, quite possibly, net consumer detriment (which would point to a downward movement from the central estimate not an upward movement).

12. Real world analysis of benefits from transferring to fibre

12.1 Actual benefits of migration are dealt with in only a paragraph in the paper.[22] A fulsome real world evidence based quantitative CBA requires much more and therefore, this does not meet legal requirements.

12.2 The single example given is the UFB ability to support “high-definition video”. We will use this to demonstrate that this impressionistic approach in a few lines is far short of the analysis required in a sufficiently fulsome real world quantitative CBA, and that in fact it is incorrect.

12.3 The fact is that most copper based broadband customers (even over ADSL let alone VDSL) get high-definition video already. This is very well known. That is often so even if this is extended to HD video for two way video conferencing instead of one way downloading. Consumers often have no or limited need to migrate from copper to fibre, as the Commission’s single example shows. Further many consumers have no need for speeds that achieve HD, such as Mom-and-Pop e-mailers, and so they have no need to transfer to fibre. Note that the Commission needs to deal too, along with 600,000 that only have voice lines, with the impact on that group of consumers from a price hike to encourage migration.

[22] [53] with the same point made in the summary at [51.1].

12.4 The Vertigan report has very carefully analysed these points when comparing options as to networks. It has concluded, based on evidence, that the drivers for migrating to faster networks (especially from fast to very fast) are low and that this is so for periods longer than the 5 year regulatory period under review here.

12.5 Significantly too there are no network effects here, in the sense that UFB is only a platform interconnected with other platforms, rather than a self contained platform. Put another way, it does the same thing as copper: it just does it-potentially, faster. What is relevant is only the increased speeds obtainable (and, possibly also, higher QoS) relative to other platforms such as DSL and 4G.

12.6 The above illustrates two points:

(a) The facts are crucial and, even in a draft, require more than a few lines of impressionistic observation (which can anyway readily be demonstrated to be incorrect); and

(b) A fact based analysis is likely to show low cross-elasticities between copper and fibre based retail services (which is demonstrated by the Vertigan report) and low additional externalities.

13. Dropping Copper prices enhances migration to fibre, says Chorus

13.1 This is a further legal point: the analysis is constrained to only a sliver (price v migration) and even then does not address the real evidence.

13.2 In June, Chorus reduced the price of VDSL[23] expressly to support migration to fibre. Thus, entirely contrary to the Commission's assumptions and Chorus' position now, Chorus supported lower copper pricing. This must feed into the CBA.

13.3 In its 2013 Annual report, Chorus stated this and gave its reasons (highlighting added):

> **"Fibre is the superior technology and we are clear that VDSL is a stepping stone to fibre."**
>
> "**In June 2013 Chorus began offering VDSL at a price aligned with the current Enhanced UBA wholesale price of $21.46. VDSL had previously been offered as a premium service with commercial pricing of $40.00 and uptake had been minimal**. The new VDSL product is expected to provide more New Zealanders with the opportunity to enjoy higher speed connections, and also make New Zealand a more attractive market for the development and deployment of high bandwidth applications. **Faster copper-based technology forms an important stepping stone to fibre. Like any technology upgrade, the move to fibre will be a long term transition and VDSL has an important role in the interim.** The number of VDSL connections had increased to 4,000 by 30 June 2013 with retail service providers beginning to market it more widely. VDSL utilises existing copper based capability and can provide download speeds of about 20-50Mbps and upload speeds of up to 20Mbps, subject to an end-user's

[23] We have submitted elsewhere that the VDSL UBA price had to be the same as ADSL based UBA, but that was not the understanding of Chorus at the time.

distance from the broadband equipment and line capability."

13.4 Given, for example, much of the UFB footprint is yet to be rolled out and all will not be completed until 2019, at contracted roll out rates, the same holds true today.

13.5 The Chorus statement is real world evidence

13.6 Real world evidence from the horse's mouth, and contrary to what Chorus is saying today.

13.7 It demonstrates that the analysis must carefully focus on all facets. It is evidence that increasing the price has negative consumer outcomes. Such an approach needs to be factored into the welfare analysis. It is evidence.

13.8 This links with the next paragraph.

14. Lower price encourages migration to fibre

14.1 In our submissions, we submitted that lower copper prices will encourage earlier migration to fibre, as that will encourage LFCs and Chorus to roll out their networks sooner than their contracted date, thereby benefitting consumers.

14.2 There is no reference to this in the paper, and so our submissions are not covered. Only the prospect of migration due to higher copper prices is referred to (and seems largely just to be assumed).

The Commission agrees with our submission

14.3 It wasn't just us making this point. So too has the Commission in its May 2012 Revised draft UCLL Benchmarking Decision (not materially changed in final). It has already been recognised by the Commission as a factor, and so it is difficult to understand why it is not covered

14.4 It is particularly noted, given the history, the concerns, and long standing frustrations outlined in this commentary, that two of the current Commissioners were on the panel, as was Chorus' now expert, Dr Patterson. Yet the paper, where the two remain as Commissioners, makes no reference to what they said. The Commission said (highlighting added):[24]

> 241. There are two main arguments regarding the possible impact of the UCLL price on fibre take-up. Changes to the UCLL price could impact on take-up of UFB services in two ways:
>
> 241.1 **From the supply-side perspective, a low copper price (and hence lower profits from the copper network) could incentivise Chorus (which has secured ~70% of the UFB contracts) to roll-out fibre, and encourage customers to migrate to the UFB network more quickly**.
>
> 242. In their submission on the draft UCLL averaging decision, Vodafone stated that "recent European research from WIK-Consult, Professor Vogelsang and Frontier Economics, identifies that lower

[24] Revised draft UCLL Benchmarking Decision 4 May 2012

UCLL rates promote efficient switching to fibre". Vodafone also submitted:

In New Zealand, the terms of the UFB set out specific requirements, including dividend and debt requirements for Chorus should a 20% fibre up take threshold not be passed by 2020. Similarly, Local Fibre Companies (LFCs) have specific targets set within their contracts with Crown Fibre Holdings (CFH) with financial penalties applying for not meeting those targets**. However, as identified by WIK-Consult and Professor Vogelsang, higher UCLL prices would result in a very strong economic driver to limit fibre roll out, to the minimum switch-over necessary to meet contractual commitments**.

248. In contrast, as noted by Vodafone, a higher UCLL price may incentivise Chorus to slow fibre roll-out to the minimum level necessary to meet their contractual commitments.

249. The Commission considers that raising the UCLL price above cost could, to some extent, reduce the risk associated with fibre investment by reducing the demand risk faced by Chorus and the other LFCs. However, the introduction of UFB does not necessarily mean that an adjustment needs to be made to the benchmarked UCLL price to incentivise fibre take-up. **The purpose of the Act is to promote competition in telecommunications markets, not to promote take-up of a particular technology over another.**

250. A lower UCLL price could be expected to promote competition by:

250.1 incentivising further unbundling by access seekers

250.2 providing greater incentives for fibre services to innovate, to exploit their advantages over copper.

14.5 Nothing like this level of analysis is being done by the Commission here with its linear approach of picking out, solely, the relationship between retail price and migration to fibre with a view to increasing prices.

15. Downward movement of TSLRIC price and WACC

15.1 One of the concerns about the paper is that it does not deal with submissions seeking downward move in the TSLRIC price and/or the WACC percentile adjustment. It is submitted that this reflects an upwards bias by the Commission, given the history and so many choices made with an upward not downward pricing effect.

15.2 It is submitted that the required fulsome real world quantitative CBA will demonstrate the movement should be downward and this should happen, given in the real world Chorus over-recovers by a considerable margin, as Professor Vogelsang observes. However, as s18 and consumer welfare analysis is rarely relevant to uplift, it is also rarely relevant to downwards movement too.

16. Copper is designed as a competitive constraint on fibre.

16.1 This is a particularly major concern for consumers (whose interests are similar to those of unbundlers in this regard, as unbundling promotes competition and that benefits consumers).

16.2 The paper makes no mention of competition from unbundlers (and others).

16.3 Further there is no assessment of uplift on the UBA price instead of an uplift on UCLL which has substantial impact on the unbundling case (and which would also solve the issue around the one third of customers above, plus the mom-and-pop users who do not need faster speeds). There is also no assessment of say, a downwards movement for UCLL and an upwards movement for UBA (whether under s 18 generally or under the obligation to consider relativity). Wigley and Company have previously submitted that a way of ensuring relativity, but avoiding an overall price increase would be to reduce UCLL and increase UBA.[25,26]

16.4 That indicates that such competition is not being considered.

16.5 We submitted that, legally, any uplift must **solely** be based on promoting **competition** for the LTBEU (a point that must be correct as it is exactly what the Act states)**.** (See for example [4] in our March cross-submission).

16.6 Further we submitted that the regulatory regime is designed to have copper as a competitive constraint on fibre, and that any departure from that is not lawful.

16.7 Repeating from above what Chorus' own expert, Dr Patterson, agrees:[27]

> "The New Zealand policy is that copper will be a competitive constraint on fibre, with uptake determined by market forces. If copper prices are set above cost to encourage fibre uptake, they will no longer constrain fibre prices, and uptake will no longer be market driven."

16.8 And repeating from above what the Commission said in its 2012 decision quoted above, the Commission agrees:

> The purpose of the Act is to promote competition in telecommunications markets, not to promote take-up of a particular technology over another.

16.9 The paper makes no mention of what Dr Patterson, Dr Gale, Ms Mazzoleni and Mr Duignan said then in that quote, with the relatively single-minded focus on favouring UFB and Chorus, where UFB is a particular technology.

16.10 Yet the Commission simply ignores consumers' submissions on this point.

16.11 Uplifting the price is contrary to the scheme of the Act as noted above.

16.12 As the Commission says, "to promote take-up of a particular technology over another" is not the purpose. That is so particularly as to an upstream open access platform that all RSPs (AKA competitors) can access. The Commission

[25] Wigley and Company, Submission on consultation paper outlining Commission's proposed view on regulatory framework and modelling approach for UBA and UCLL, paragraph 246.
[26] Wigley and Company, Submission on draft pricing review determination for UBA and UCLL services, 20 February 2015, section 16.
[27] http://www.stuff.co.nz/business/opinion-analysis/8058701/Government-interference-doomed

must show, quantitatively, why favouring migration to UFB **promotes competition** per se.

16.13 Uplifting the price reduces competition from unbundlers and that is contrary to promoting competition, which is the sole focus of s 18, and constraining fibre prices. Whatever s 18(2A) might say, s 18 is solely about promoting competition. Uplifting the UCLL price but not the UBA price is contrary to the sole focus of the Act in that regard.

16.14 An artificial uplift in price can be seen as analogous to import tariffs that were used to protect NZ manufacturers from competition i.e. it would restrict or lesson competition.

16.15 Of course the various factors need careful consideration and balancing as quantified benefits and detriments. But the current point is that focusing only on migration to fibre is unlawful; indeed it may be that it cannot be a factor in a proper CBA, complying with the Act.

16.16 We add also that it is unlawful to set the UCLL and UBA prices to discourage unbundling eg by Spark and others. The purpose of the Act (promoting competition) has promoting unbundlers trumping other objectives such as promoting migration to fibre by a considerable margin.

16.17 As Professor Cave has pointed out (and as we have noted in the March cross submission at [9.27]) in his submission to MED on the Telecommunications Act review, there is a policy argument that migration from copper should be encouraged, to facilitate stopping the inefficient cost of running two parallel networks.

16.18 But even if that argument has merit, it is simply not available as an option for the Commission as the Act is clearly designed to encourage competition from copper. In other words it presupposes the copper network continuing in parallel.

16.19 In summary, the primary focus must be on pricing that encourages competition and that in practice means from unbundlers; even if competition from fibre is material, competition from unbundlers must be considered. Similarly competition from bitstream based providers must be considered. In the mix may be other competition such as mobile, WiFi etc.

16.20 Clearly pushing up the UCLL price will harm competition from unbundlers. That must be quantified into the CBA and the analysis must have regard to the Act's requirements.

17. Commission fails to distinguish real world evidence from hypothetical evidence

17.1 We introduced above the need to pivot off real evidence. There is particular concern that the paper, contrary to submissions by both us and CEG, treats much of the analysis as hypothetical when the s 18 analysis must be a real world one. Here is a key example.

17.2 The paper takes the following incorrect approach at [71], it is submitted:

> We also note that we have not considered whether a reduction in the UCLL price to a level that is below our central estimate of the TSLRIC for the UCLL service might be justified. **This is because setting such a regulated price will not by definition allow for the recovery of the**

> **efficient forward-looking costs of supplying the UCLL service, and is likely to therefore have a detrimental effect in terms of competition and incentives for efficient investment in the future**. This is unlikely to best give, or likely best give, effect to the section 18 purpose statement.

17.3 Contrary to the CEG and Wigley submissions (see eg [9.6] to [9.11] of our cross submission), the Commission takes, as to s 18 a hypothetical approach in the passage above instead of a real world approach.

17.4 Contrary by the way to the advice from its own expert, Professor Vogelsang, who said that Chorus amply over-recovers in the real world. As submitted, it is expected a proper CBA will demonstrate that the Professor is correct.

17.5 At [9.9] to [9.11] we even set out a critique of the same error by CEG that the Commission is making (as to mixing the hypothetical nature of modelling the HEO's costs with the real world approach promoted by CEG for s 18).

17.6 Thus we gave an example of what not to do, but that is what the Commission has done.

17.7 This is also an example of the Commission doing what the IM court said cannot happen: making unsubstantiated conclusions.

17.8 It demonstrates how important it is to be clear as to how each step is applied, instead of briefly stated and unsupported aphorisms and catchwords such as efficient prices etc.

17.9 Additionally, this raises the need to consider relativity between UCLL and UBA, an issue also to be resolved having regard the sole focus on encouraging competition, and based on the fulsome real world quantitative CBA too.

17.10 Finally, as noted above, this is another example of the Commission focusing only on upward and not downward movement.

18. UCLFS and wholesale homeline

18.1 Callplus has submitted that the overlap of UCLFS cost pricing and wholesale Homeline retail pricing has increased the prices payable by RSPs and in turn by end-users. For UCLFS customers, the Commission, without dealing with this evidence, has not factored this into their analysis. That is required though. The problem is particularly acute for non-broadband voice customers

19. Consumer welfare analysis is multi-faceted

19.1 The points above demonstrate that net benefit/detriment cannot be determined by a narrow focus on just one facet such as retail price v migration to fibre (particularly where the focus is solely on upwardly moving the copper price).

19.2 Significantly, we (and other parties) have submitted that point numerous times including as to narrow focus on "reasonable investor expectations" and then on "predictability".

19.3 Notably we did the same as to the CEG paper on the same topic: copper price v migration to fibre. See for example [9] in our March cross-submission, as to which the paper makes no comment.

19.4 Yet the Commission still models on a single dimension – but now in a different incarnation - without regard to those submissions and the broader facts and factors. Again, the impression is one of submissions being by-passed.

19.5 There are multiple considerations but one of real significance to consumers is that, without even dealing with their position, and contrary to submissions, the Commission feels able to push up pricing for around a third of copper-based retail customers who do not get countervailing benefit from migration without even addressing their predicament. Generally that one –third (lower income and rural) face a digital divide, made worse by the approach.

19.6 It seems also that the Commission's approach does not deal with copper based customers paying higher prices when UFB is not yet rolled out in their streets. See [9.17] of our March cross submission. That is a further category to consider.

20. Current position

20.1 We summarise the current position arising out of the above points and then turn to consequential issues.

20.2 We have now reached a point where:

(a) This Commission paper, representing a major change, is produced a long time after much modelling has been done, and less than a fortnight before the conference.

(b) Like a number of other steps, it came "out of the blue" for parties. It's a third change on the same issue, only a few days before the conference.

(c) The paper and the approach is, it is submitted, well short of what is legally required.

(d) Parties and experts are not allowed to provide written material for the conference and, at least until Wednesday's announcement, there was no space for other written submissions on this. That meant that the parties were working on the basis that the requested views on this paper are limited to verbal comments. That was unrealistic and impossible, beyond the cursory. Parties and experts would get only a few minutes to submit at the conference (that surprising expectation, as to a paper produced so late, raises further questions as to process).

(e) We explain below why short term solutions such as a time to make submissions remains deeply problematic, in our submission.

(f) Prior to that change the parties faced the disjointed situation of a CEG report, carved off for separate and subsequent submission (the responsibility for which lies with Chorus).

(g) All this points to another example of a process that is unworkable and disjointed by a substantial margin, after over two years in the circumstances noted in this commentary. Going into a conference in this state of disarray (eg the parties are in the dark on multiple issues due to the deficiencies in the draft) is an example. Regrettably, it is submitted that multiple process issues by the Commission have primarily caused this, commenced by no action for nearly a year.

(h) Among our multiple submissions on process, we, in April and other times last year submitted (again, without response from the Commission) that going slower is often faster overall: we gave, as an example, the problems faced by the Electricity Authority, in similar circumstances, where it had undertaken a stream-lined approach to review of the transmission pricing methodology and this resulted in the process taking much longer than it otherwise needed to. The Electricity Authority is due shortly to release its tenth working paper for consultation, following its original October 2012 proposals, with a revised set of proposals expected approximately 3 years after the initial consultation. We submit that this is the sort of path the Commission is heading down with the sort of disjointed and incomplete approach that is currently happening. With planning, and industry/consumer support so far as possible, this can still be avoided.

(i) This submission is made directly – an uncomfortable thing to do - and highlights the submission that we are in this predicament since the review started over 2 years ago. Less direct submissions – yet relatively direct anyway such as this year's submissions and letters- have not led to change (indeed there has been almost no response to those submissions) and the problems have continued, illustrated by a conference as to which the parties are in the dark on many issues due to absence of reasons and engagement with the submissions in the draft determinations, etc, where key modelling decisions have been made on incorrect s 18 grounds, and, without the real world evidence based quantitative CBA the law requires: when that is done, the Commission will need to revisit all its prior s18 based decisions (and there are multiple other issues to revisit).

(j) There is still opportunity to regroup to get this right. Consumer representatives in particular will strongly support that. But it calls for a careful re-think and a re-setting, not just iterative and reactive steps such as giving time to submit on the paper when submitting on the CEG paper, as problems emerge due to the "out of the blue" paper a few days before conference.

(k) As we pointed out in our last letter, the circumstances overall can lead to a court concluding that there are legal process errors in combination. That includes as to the history outlined in this commentary.

(l) On this, we repeat a concern expressed in our 2014 submissions: there is a concern that the point is arrived where the Commission may make decisions because it perceives it is too late to go back on flawed decisions such as those based on the impressionistic s 18 analysis. We said then that this raises public law concerns. That concern is now to the forefront (for example, as to modelling choices that have been made such as aggregation, contrary, it is submitted, to the Act). We deal with those concerns further under our heading, "*The paper continues the perception of an upwards bias".* A decision to stay with an earlier but flawed draft decision, due to passing of time, will be firmly opposed.

21. Consumers' perspective

21.1 Quite apart from the legal obligation on the Commission to produce a fulsome evidence based empirical analysis, consumers are heavily reliant on that happening. The Commission is the s 18 guardian of the interests of the consumers. It is not realistic for consumers to do a real world evidence based quantitative CBA.

21.2 We have three main quantitative CBA threads emerging from parties in the current submission round (the original Dobbs model, CEG's adaption of the Frontier-Dobbs model and also the Spark's analysis of low income household impact), with other empirical smatterings here and there.

21.3 It does not meet the Commission's legal responsibility just to deal reactively with those submissions. It does not meet the Commission's legal responsibility to simply respond to parties' submissions on CBAs going forward. The Commission must do its own fulsome analysis, but that is also very important for consumers whatever the legal position.

21.4 In particular, consumer interests do not want to be on the losing end, relative to the regulated supplier, due to the Commission's submitted error of not doing an evidence based quantitative analysis some time ago, especially before the modelling decisions made last year before and while TERA did its work. The Commission did not progress the UCLL FPP for nearly a year and this also has contributed to the current predicament. It is submitted that the Commission has a responsibility to consumers to remedy the position so that there is a fulsome quantitative CBA prepared by the Commission, so that changes are made as necessary as a result of that analysis (without being held back due to the late timing of the fulsome quantitative CBA), and so that s 18 and that analysis are only applied where that is permitted. The same applies to all other facets of the FPP process.

Consumers perceive they are not being listened to enough

21.5 Consumer interests have long been concerned that their voices have been side-lined in decisions, in participation in conferences, and so on. Yet they are the sole focus of the Commission's work under s 18. A reading of the uplift paper, as to issues where consumers (with 2 RSPs) have taken the lead on some points, sees this continuing, as it has throughout multiple papers and decisions including back to the IPPs. (That is so even though there are some positive changes).

21.6 For example, the main focus is on what Chorus, Vodafone and Spark have to say, even where the consumers have taken the lead on the issue. See for example [37] of the paper. To be emphasised is that this is not a lip service type of concern. It is far deeper and more fundamental than that, in terms of actually engaging with submissions fulsomely.

21.7 There is the perception on multiple issues that the belle of the ball, Cinderella Consumer, is left sitting beside the dance floor, watching the ugly step sisters vie for the handsome prince and demanding an uplift in the size of the slipper so that their overly fat feet can fit into it.

21.8 The legal obligation to engage with the parties' submissions in draft and final determination will go quite a way to ameliorate this concern, as would doing so in other papers.

21.9 Imagine if the Commission had early on accepted submissions, made multiple times back to IPP days, that the law requires a fulsome quantitative CBA. We were largely the only parties submitting for this. The Commission would not be in its current predicament of having, it is submitted, to now do the full CBA and rework the consequences flowing from that.

Practicalities for consumers at the conference

21.10 The agenda notes that it is intended generally to question experts first, and then enable parties to comment. Generally, it is understood the structure needs to be managed and there are challenges. But we note in particular:

(a) Unless handled carefully by the Commission so that consumers (and smaller RSPs) get a say – there have been problems in the last conference for example – the consumer can be denied a practical voice when as above they are at the centre, not RSPs or their experts.

(b) The Commission should, it is submitted, therefore go to some effort to ensure the consumer voice is heard, when it has no experts.

(c) The Commission is fortunate in having a consumer voice as that is unusual in regulatory matters.

RSP proposed agreement on price in 2013

21.11 This never was relevant in any way to the FPP approach and in any event, what some RSPs might have agreed then is now irrelevant even from their perspective. We have moved on and there is more information. Plus such an arrangement would have been a compromise to avoid the risks of an up or down UBA uplift.

21.12 In any event, many RSPs were not party to that proposal including Snap. Other RSPs' views cannot reflect theirs.

21.13 However the key point is that consumers were not party to the proposed agreement and can be expected to have opposed it, if they were aware, given, to the extent there is pass-through, the RSPs are not financially affected: only consumers are. Such an uplift would have been a poor outcome for them.

21.14 RSPs such as Callplus and Spark cannot have full pass-through now, so there position would be different too.

21.15 In any event, UCLL pricing was not being agreed then and therefore CallPlus is independently affected by any model pivoting around that UBA uplift letter.

22. The paper continues the perception of an upwards bias

22.1 Parties have submitted that, when the Commission realised that the "reasonable investor expectations" would not justify an uplift, it then moved, again on a largely single dimension s 18 analysis excluding other factors, to a "predictability" justification. Notably, exactly the same outcomes resulted. This had the effect of the Commission being able largely to retain its existing modelling decisions.

22.2 Whatever the underlying actuality, there is a perception that grounds that are being eliminated by submission are simply being replaced by other grounds by the Commission, with the effect of coming to the same ultimate conclusions.

22.3 The Commission paper heightens that concern, for the reasons outlined above (for example the focus solely on migration to fibre, only upon UCLL, only upon fibre providers and not, for example, unbundlers, only upon upwards movement, and the absence of a fulsome quantitative CBA). This, against the background of the marked disparity of the Commission's draft conclusions vis-à-vis the

material produced such as the Spark graph showing comparable OECD UCLL pricing. (Even with adjustment to accommodate local features and any issue such as raised by Chorus, the graph will show how extreme the upward pricing is).

22.4 Parties have some straight forward data and benchmarks to show the court why the process and substantive alleged errors, and the sort of seemingly upwards bias noted above, may be leading to incorrect outcomes by a substantial margin, by reference to simple information.

23. The conference – a caveat

23.1 To save repeatedly caveating our clients' participation in the conference, which, for example, of necessity focusses on more impressionistic analysis as we have submitted, participation is subject to and based on this commentary. For example, discussion of the specific features of modelling in the Commission paper, upon the December draft etc, is based on the caveat that an impressionistic approach is not legally available.

23.2 There is value though in discussing those high level features as, for example, they help focus the necessary detail of a fulsome evidence based quantitative analysis.

23.3 There is a further issue. Many of the topics at the conference, especially the first topic (framework) have features that are not primarily matters for expert economists. At the IPP conference there was the unusual scenario where economists were asked questions outside their primary expertise in this regard, and that the parties and those better able to handle the matters were side-lined. We expect this can readily be managed by the Commission, for of course, for example, framework does raise some issues for expert economists.

24. WACC uplift

24.1 We reiterate that a fulsome real world evidence based empirical analysis is required and, as with TSLRIC, to determine whether any deviation from mid-point WACC would lead to **promoting competition** in the LTBEU. We also reiterate that the Commission's Part 4 WACC percentile review, conducted last year, provides an appropriate precedent for the type and level of analysis required for any such analysis. In this respect, we support the Commission's decision to contract Oxera to undertake further work on WACC percentile modelling. We consider that it would be helpful to once again contract Professor Vogelsang to review Oxera's modelling work, and to contract Dobbs to review CEG's application of the Frontier-Dobbs model.

24.2 The Dobbs model/Frontier Dobbs model, if applied appropriately i.e. distinguishing between sunk, deferrable and non-deferrable investment,[28] could be useful in providing evidence of the direction and basis for any such deviation from mid-point.

24.3 In this respect, we caution against the Commission's main draft justification for an uplift:

[28] Critically, CEG disregarded this aspect of the Frontier-Dobbs model and treated all investment as deferrable.

> 82. Although investment in innovative new services will typically not be captured by existing UCLL and UBA regulation, the decision regarding whether to apply an uplift to the mid-point WACC for UCLL and UBA could potentially send an important signal to investors in telecommunications services more generally – particularly if there is the prospect that the new service(s) could be regulated in the future.

24.4 We have previously cited High Court commentary from the Part 4 IM Merit Appeal decision as to why differential treatment of sunk and new (non-deferrable and deferrable) investment can be appropriate. We remind the Commission that the High Court decision was made in defence to the Commission's Regulatory Asset Base IMs which drew a line in the sand and valued sunk investment on the basis of historic ODV, and new investment at actual cost. The commentary in paragraph 82 puts the efficacy of the approach in the Regulatory Asset Base IMs into question.

24.5 If potential signals from treatment of UCLL and UBA is a factor to be considered (we say it is not for the reasons below) it must be quantified, along with other efficiency factors.

24.6 That factor can only justify an uplift if it promotes competition for LTBEU. That would need to be clearly demonstrated as to this objective that is relatively remote from copper (and UFB).

Uplift not available in any event

24.7 But, critically, there can be no justification whatever for such an uplift, as it is very easy (and essential) for the Commission to manage the signals sent by setting copper based WACC, a point that is made, but not dealt with by the Commission, at [9.31] of our March cross submissions). We note:

(a) Deciding copper based WACC is fact-intensive, based on the specifics of copper (and its MEA).

(b) The High Court decision and the Commission's IMs (see discussion above) provides support/precedent for a differential approach to copper and fibre services. This is also reinforced by the direction from the High Court in the IMs decision for the Commission to consider a "two-tier" approach to the WACC for sunk and new investments.

(c) Other regulated services have different WACC calculations even if, as should happen, those calculations will share some inputs.

(d) The Commission can stop any signals around future regulation by clearly stating this and confirming new investment and regulation will be handled differently if necessary (even though that is not strictly needed). That eliminates entirely the signalling aspect of the copper WACC decision.

(e) There is an illustration of this. No one would suggest that the regulatory retail minus UBA pricing, left in play for 3 years, has any influence on the new cost based pricing. While retail minus does not include WACC, it can readily be concluded that a "precedent" is distinguishable.

25. Timing in the FPP process from this point

25.1 We now deal with all facets of the FPP, not just s 18, as we understand the Commission is reviewing its timelines.

25.2 From the above, and from submissions beyond the s 18 considerations, it is submitted that the overall process is moving even further into being disjointed and unworkable, by a substantial margin.

25.3 There are some short term potential solutions to that: for example, as to the TSLRIC uplift issues, it seems relatively simple to allow written submissions on the paper and on the CEG paper in a way that is coordinated, and meshes with what seems likely: a submission round on the WACC uplift following the Oxera paper. And indeed that has happened as to a May date for uplift submissions.

25.4 But, continuing with the same example – the TSLRIC uplift – this will not solve for what are submitted to be more critical defects such as the absence of a sufficiently fulsome evidence based quantitative CBA.

25.5 Consumer interests, as outlined above, are heavily dependent on their guardian – the Commission – doing the fulsome quantitative CBA. The Commission's role is, by statute, about the consumers. They do not want to miss out as the Commission only started to move down that quantitative CBA path over two years after the review commenced.

25.6 In this TSLRIC uplift example, those factors point strongly to carefully standing back and reassessing the approach, rather than what has happened in the past: applying the short term solutions, only to find yet another change is required.

25.7 The concerns of this gravity extend well beyond the TSLRIC uplift issues. It is submitted that there are multiple big ticket items that individually impact the final pricing in major ways. It is not possible nor appropriate to narrow the focus.

25.8 Any decisions should be informed by timing estimates outlined by the economic experts such as TERA, Analysys Mason, CEG, WIK and Network Strategies. They would need to take account of possible major changes in the modelling, although many such changes may be largely changing the inputs into a spreadsheet (eg ORC v historical cost) rather than major reworking. (However, if such major re-working is required it must be done).

25.9 For those reasons, it is too difficult to make detailed process timing proposals. There are too many substantial issues at play - save that the Commission should make a big call to review radically the path and that it should avoid locking itself into what is not or may not achievable, taking into account the guidance from past history over many years, which we have summarised in our multiple FPP submissions. The EA experience noted above is particularly salutary.

25.10 We consider that there are too many issues in play where there are difficulties for rudimentary and reactive decisions on timelines to be made. We therefore do not suggest that happen, beyond expediting what we consider is on the critical path to earlier resolution of the final FPP:

(a) Complete for consultation a draft sufficiently thorough real world evidence based quantitative CBA;

(b) Establish the draft legal position on the extent to which s 18 adjustments can be made (we have submitted that will be rare) and then revisit in draft, for consultation, the modelling decisions where s 18 has been applied.

25.11 Essentially, the point is now reached, it is submitted, by which, after the conference, the Commission should undertake a major review to reset the approach. Given the sums involved, getting it right trumps speed by a substantially margin, as we have submitted multiple times such as at [4] of our February submission. That is a consistently strong message that has been given by consumer interests and it has had only a single sentence response from the Commission.

25.12 Adding iterative steps has worked very well in the past and will work well going forwards, instead of a more big bang type of approach.

Gaps in the information reviewable by the experts

25.13 WIK and Network Strategies submissions show that parts of the modelling and evidence have not been given to them. That of course raises public law issues as to adequate consultation, to be remedied (in a way that is planned and meshed with a re-worked approach).

One off charges

25.14 We can be clearer however around this. Currently one off charges are to go to draft determination, a submission phase, and then a final determination, with no conference. Like the monthly charges these raise large $ issues, with particularly substantial impact from a consumer and smaller RSP perspective around barriers to churn.

25.15 What has gone badly – and well – for the monthly charges process can help inform the one off charges process. It is submitted that there are strong signs that the Commission should insert more steps, such as what most regulators do: have a draft model reference paper for one off charges, with a submission phase. If the monthly charges FPP is optimally reset, there will be time to do this.

25.16 It is submitted that the one-off charges tortoise will get there faster, and better, than the hare.

S 30R review

25.17 Similarly this can be structured, ideally to coordinate with the FPP, with the benefit of learnings from the FPP. For the reasons in our s30R submission, there is much to be said for doing the 30R in parallel and integrated with the FPP.

25.18 Noted is that the Commission is yet to respond to multiple issues in our s30R submission, and those of others.