Wigley+Company solicitors

Submission on consultation paper outlining Commission's proposed view on regulatory framework and modelling approach for UBA and UCLL

Public version (there is no confidential version).

Table of contents

Executive Summary

1. Support for a number of Commission steps is noted, as is the high degree of comfort that agreement among all but Chorus provides. This is dealt with first in the body of this submission.

2. The Commission had only previously undertaken a TSLRIC determination process once, for PSTN services, and this ended at the draft determination stage.

3. The closest precedent the Commission has for completing the TSLRIC exercise is modelling the net cost of the TSO.

4. While aspects of the TSO modelling exercise are relevant to TSLRIC modelling it should be recognised that the Courts found there were a number of deficiencies in the way the Commission determined the TSO net cost that resulted in an overstatement of the net cost. In particular, the Commission failed to adequately ensure the net cost determination reflected that of an "efficient service provider" (comparable to the TSLRIC concept of a hypothetical efficient operator), or to adequately take into account alternative technologies (notably wireless). We canvassed these in previous submissions.[1]

5. The biggest risks we see arising from the TSLRIC determination process are that:

    a. the Commission does not adequately optimise the UCLL + UBA network, and adopts other positions, such as that re-usable assets will be valued at ORC, that will inflate the TSLRIC prices and result in windfall gains to Chorus at the expense of end-users. The more reliant the Commission is on Chorus' network design and costs the more divorced the TSLRIC determination will be from the MEA of a hypothetical efficient operator.

    b. The Commission does not undertake the process within its legal obligations such as the requirements of the Act, legitimate expectation, etc.

6. As to that last point, this is the first time for some years that the Commission has moved away from an IPP level of decision making where the requirements are significantly lighter. An FPP has requirements up there with, for example, the original decision to reject making UCLL a regulated service. This is an appropriate process in which to revisit what is required in relation to supporting evidence, consultation and giving reasons. The current approach is well short of the established Commission approach and the legal requirements.

7. There is much that the Commission can do to reduce the risk in this regard, including the risk of otherwise unjustified appeals and judicial review. In other words there are positives in this for the Commission, and not just the potential for attack by stakeholders. For example, the courts say that, where a decision maker has set out sufficiently fulsome and reliable reasons, and dealt adequately with submissions, they

[1] Refer: Orcon, Cross-submission on the further consultation on issues relating to Chorus' UCLL and UBA services, 30 April 2014, section 7. Refer also: CallPlus and Orcon joint submission, Cross-submission on the further consultation on issues relating to Chorus' UCLL and UBA services, 11 April 2014, paragraphs 7.8 – 7.20.

are less willing to intervene on appeal or judicial review. The decision maker has demonstrated that it has applied its expertise correctly and therefore the court is more likely to defer to the expert tribunal. Therefore, taking the approach we propose will likely markedly strengthen the approach of the Commission.

8. For convenience, the main legal concerns are set out in tabular form at the end of this submission.

Section 18

9. Our view is that the Commission is departing considerably from its obligations around s 18 and 19, when it had undertaken the analysis correctly as to IPP in relation to where s 18 did and did not apply. In particular, s 18 considerations seem to be growing wildly like triffids, in gardens where only cost and other non-s 18 evidence and analysis can grow. Determining cost (which the IPP is solely limited to) is very different from determining efficiencies. They are different issues and the only solution is for the efficiency analysis to apply only when plausible ranges are reached.

10. Further, as noted below, the clear requirement to apply s 18 using evidence not supposition, and with a quantitative cost benefit analysis, is not being met. For example, the Commission cannot, legally, conclude, with no evidence in support, that dynamic efficiencies trump static.

11. Despite those issues having been raised in submissions (that is, 18, and also the need for robust evidence and quantitative analysis including beyond s 18), the paper does not deal with the submissions. On s 18 the paper even cites submissions that support the Commission's conclusion without, as is required, dealing with the opposing submissions.

12. Relativity is however a unique case because the Act says so. Relativity questions do allow greater intrusion on the price difference as between UCLL and UBA. However that should be achieved by moving the UCLL price down and/or, if there is a fibre based MEA for the UBA uplift by increasing the UBA uplift, modestly. We propose a way this can be done in a principled way.

13. Out of the blue, and without reasoning, has come the prudent investor and predictability concept. It is not even a feature of the IMs where the legislation specifically refers to the provider's own interests. This does not comply with the Act, but in any event, the parties would need to see reasons so they can submit.

TSLRIC determination time-frame is still too truncated and creates risks of a bad outcome

14. The Commission is aiming to complete the TSLRIC determination process within a very ambitious time-frame. We still consider the time-frame to be unrealistic. We note the earlier detailed submissions by us, InternetNZ, CallPlus and Orcon which we don't repeat here.

15. The time-frame is a lot tighter than any Commission precedents for price/cost determination processes. Notably, it is a lot tighter than the process for the benchmarking/IPP price determination processes for UCLL and UBA, despite price

benchmarking being a much simpler exercise that is intended to be much quicker than a TSLRIC determination process.

16. We consider that the changes the Commission has made to its TSLRIC determination process, including additional consultation steps and extension of the time-frame for making the TSLRIC determinations, to be an improvement. But the changes only partially address the concerns we have raised.

17. We remain of the view that the process risks determination of excess TSLRIC prices.

18. There may be a temptation, on the part of the Commission and TERA, to overly rely on Chorus' actual costs and network architecture/configuration even though TSLRIC is the cost of a hypothetical efficient operator, not the costs of the actual access provider. Our submission on UCLL and UBA WACC shows an example of this happening. The absent of a sufficiently detailed model reference paper is another.

19. The one clear theme from Chorus, and its consultants AnalysysMason, Chapman Tripp, and CEG, in their submissions, was to try and argue for the TSLRIC determination to match Chorus' actual service, network and costs as tightly as possible; including the improbable claim that there is no reason to assume Chorus, as a natural monopoly service provider, would have inefficiently high costs.

20. Likewise, it may be simpler and more straightforward to undertake only modest efficiency adjustments to determine the TSLRIC price. We are uneasy about the Commission' undefined references to "Reasonable Efficient Operator", "Equally Efficient Operator" and "realistically efficient operator" and the scorched node approach it is proposing appears to provide for relatively modest optimisation of Chorus' network and costs.

The Commission should not rely on Chorus' TSLRIC modelling. It can be taken as a given that their cost calculations will be inflated

21. We understand that Chorus has undertaken TSLRIC modelling for UCLL and UBA services, including variations to the modelling to identify the key drivers for the cost determination, and the range of potential outcomes that could come out of the TSLRIC determination process.

22. We are not aware whether Chorus' intends to provide the Commission with any version of its TSLRIC modelling, but we would caution against any reliance on it.

23. The pre-Telecom split Chorus provided its cost modelling for the TSO cost determinations and the (uncompleted) PSTN TSLRIC determination. The results were grossly inflated calculations of Chorus' costs. Chorus' calculation of the net cost of the TSO was also grossly inflated compared even to its own previous calculation, under the Telecommunications Information Disclosure Regulations 1999, let alone compared to the Commission's net cost determinations.

The Commission needs to ensure its decisions/judgments are evidence based and there is careful analysis

24. One of the biggest concerns we have is that, in most areas where the Commission is exercising discretion and its judgement, there is a lack of detailed explanation or evidence to support the Commission's position. The still truncated TSLRIC determination process heightens this risk as it will make it more difficult for the Commission to ensure the judgements it makes are based on (fully articulated) analysis and reasoning, supported by evidence to the extent practicable.

25. An FPP markedly ratchets up the level of evidence and analysis required. This is a very different league from IPPs. For the first time for some time, the Commission is moving beyond the "quick and dirty" IPP stage. In doing so it is not following the practice it has established and applied when dealing with the larger decisions beyond IPPs and the like.

26. For example, the standard required of FPPs is comparable to the standard required of processes such as the decision as to whether or not to regulate UCLL. There the Commission decided.[2]

> The Commission considers that it is required to attempt so far as possible to quantify detriments and benefits … This is not to say that only those detriments and benefits that can be measured in monetary terms are to be included in the Commission's analysis[.] Those of an intangible nature, which are not readily measured in monetary terms, must also be assessed.

27. That is the standard, and not the standard from quick and dirty IPPs. The latter are different.

28. The Commission is currently departing from its established practice on such higher level decisions, of which FPP is one. For example hardly any evidence is produced on the s 18 efficiencies analysis. Very little analysis is undertaken, and the very light analysis in the IPP in this area is relied upon. This is far removed from what the Commission has historically done.

29. In particular, on the FPP, the Commission wants to apply, as if from Moses' tablet, the commandment that dynamic efficiencies trump static, without the need for evidence. That is contrary to its own practice, outlined above, contrary to the Court of Appeal decision quoted below, and contrary to the strong rejection of that approach by the High Court Judge and the two highly experienced Lay Members on the IM appeal.

30. We are surprised this approach would be taken when the IM judgment was so clear on the point. We are also surprised that the approach is taken when the IM judgment was referred to in earlier submissions, and this very point was referred to. But that has been ignored in the FPP framework paper.

31. We develop in detail below the level of evidence required for decisions made by the Commission on FPPs. It is markedly higher than for IPPs given the intended quick nature of the IPP process. The High Court 2013 decision in the Part 4 IM Merit Appeal provides

---

[2] Paragraph 75 of the Commerce Commission's "Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network - FINAL REPORT", December 2003.

clear guidance that decisions need to be evidence based to the extent practicable, and not just based on assumption or judgement.

32. Much of the analysis for example on s 18 would be dismissed by just one observation by the High Court given the near absence of evidence:[3]

> "Where a proposition is simply asserted by economic experts, we give it little or no weight."[4]

33. We track other authorities as well. In particular, we refer to the Court of Appeal decision in *Telecom Corporation of New Zealand Limited v Commerce Commission* [1992] 3 NZLR 429 at 447, where it was said, in relation to the Commission:

> … the desirability of quantifying benefits and detriments where and to the extent that it is feasible to do so…there is in my view a responsibility on the regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.

34. The Commission's current Part 4 WACC percentile consultation provides a useful benchmark for the type and level of analysis and evidence that should be provided to support and determine the Commission's position on TSLRIC. We are concerned though that this has not been reflected in the consultation material the Commission has released so far, and may not even be possible given the Commission's targeted date for completion of the TSLRIC determination process.

It would be a mistake to inflate the TSLRIC cost calculations

35. We are concerned the approach the Commission will adopt to the TSLRIC determination will be too closely linked to Chorus' actual network and costs rather than the cost of a hypothetically efficient operator. We are conscious that there are is a spectrum of possible outcomes between these two points. This is reflected, for example, in our WACC cross-submission where we comment, in particular, on the observation of PricewaterhouseCoopers that Oxera are overly reliant on Chorus' data, and that Oxera explicitly state that they are estimating the WACC of Chorus.[5]

36. We are also particularly uneasy about the Commission's "intention to respect reasonable investor expectations to avoid the risk of chilling investment, when combined with the associated positive externalities and migration efficiencies from the generally higher prices that may result (from our decisions on the performance adjustment, and reuse of Chorus' assets), will best give effect to the section 18 purpose – without directly raising prices further".[6]

37. Leaving aside the contradictory statement that the Commission's proposals may result in "generally higher prices … without directly raising prices further", we object to any suggestion that the Commission should err on the side of "generally higher prices" or that "the risk of chilling investment", "positive externalities" or "migrations efficiencies"

---

[3] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013

[4] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1745].

[5] CallPlus, Cross-submission to the Commerce Commission in response to the Commission's expert reports on the cost of capital for the UCLL and UBA price reviews, 4 August 2014

[6] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraphs 101 - 103.

provide a sound basis for erring on the side of "generally higher prices". The Commission appears to be making the same mistakes, identified by the High Court, that it made with its decision to set the WACC percentile for regulated suppliers under Part 4 of the Commerce Act at 75th e.g. relying on assumptions about the appropriate approach to take, and not undertaking empirical analysis to verify the merit of the decision.

38. However, in any event, this "reasonable investor" concept is not permitted by s 18.

Introduction and opening comments

39. We thank the Commission for the opportunity to submit on its Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, dated 9 July 2014, and related material. No part of our submission is confidential.

40. As an opening observation on the material that was released, we are concerned that the TERA report "TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: ModernEquivalent Assets and relevant scenarios", dated July 2014, only reflects pre-2014 consultation and submissions. It does not appear that all submissions have yet been considered as part of the Commission's TSLRIC determination process. This raises legal considerations outlined in the table at the end of this submission.

41. We also note the material the Commission has released is still very high level in terms of how the TSLRIC modelling will be undertaken, and in terms of the justification/evidence in support of the Commission's position on each of the aspects of the TSLRIC modelling approach that are discussed in the consultation material.

42. If the Commission still intends to meet a December deadline for a draft determination and April 2015 for final we would have expected the Commission to have made considerable more progress than it has. We do not believe that either date is achievable for anything like a robust and safe determination.

Point of clarification: re footprint of UCLL and UBA services

43. The Commission has made the following statements in relation to our view on the footprint of the UCLL and UBA services:[7]

> Orcon and CallPlus took a similar view, suggesting that the modelling of the UCLL and UBA services should be based on the existing footprint of commercially available DSL services.
>
> We find these submissions, which read down the statutory definition of TSLRIC, unsupported by the statutory language, context and broader scheme of the Act, and therefore unpersuasive. As Dr Every-Palmer suggested, if such an interpretation of the Act was intended, we would have expected Parliament to be clear and unequivocal that this was its intent.
>
> Our view, consistent with other submitters, is that Parliament intended us to undertake a more conventional TSLRIC exercise, by building a TSLRIC cost model to determine the costs incurred by a hypothetical operator using the most efficient means at any point in time to provide the service.

44. With respect, it appears that the Commission may have misconstrued our views. We agree entirely that the "TSLRIC exercise" is "to determine the costs incurred by a hypothetical operator using the most efficiency means …" This view does not contradict or refute the point we were trying to make about the footprint of the service. The TSLRIC exercise is to determine the cost of a hypothetical efficient operator, providing the UCLL and UBA services that Chorus' provides.

---

[7] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 86.

45. If Chorus does not provide UCLL and UBA services in higher cost places such as remoter rural areas, the costs of doing so are irrelevant to the TSLRIC determination process.

46. Inclusion of high cost areas where service is not provided would inflate the TSLRIC price. The Commission needs to determine the cost of providing UCLL and UBA services where they are currently provided i.e. within the footprint of Chorus' network. (By way of analogy, when the Commission determined the net cost of the TSO it calculated the losses of providing TSO services to, pre-Telecom split, Chorus' actual customers only.)

47. We do not believe our view is any different from the Commission's statement that "We do not intend to use TSLRIC to redefine the services. Instead, we will use TSLRIC to calculate the forward-looking costs of providing the relevant services".[8]

48. The extent of the service being modelled is limited to DSL footprint (that is not a view based on the MEA of the service but rather the geographic scope of the service being priced). We think this qualification addresses fully the point made by Telecom, and referenced by the Commission,[9] that "The difficulty with Chorus' and Callplus' proposed approaches is that, by tying the MEA tightly to characteristics of the current Chorus network and the way in which Chorus provides services today, it artificially bounds the scope for Commission's assessment of efficient costs. This means the Commission can't set a price that best reflects FPP or section 18 outcomes".[10]

49. We, accordingly, share the view of the Commission that "we intend to make a hypothetical assessment of the efficient cost today for an equivalent service, unconstrained by Chorus' (or end-users') historic technology choices, but capturing the "core functionality" of the regulated service".[11] This means that if a hypothetically efficient operator could reduce costs, compared to Chorus, by having wider network coverage this should be reflected in the TSLRIC modelling. If extension would just add cost it would violate service equivalence and should be excluded. The point we were trying to make was that the geographic scope of such a hypothetical service is the current DSL footprint.

[8] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 199.
[9] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 104.
[10] Telecom "UCLL and UBA FPP: further consultation and supplementary paper - Cross submission" 30 April 2014, paragraph 15.
[11] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 105.

The Commission should take a high degree of comfort from the level of consensus amongst submitters (apart from Chorus)

50. Apart from the matter of relativity,[12] there is general consensus amongst all parties, other than Chorus, on most matters, including but not limited:

    a. Separate prices should be established for SLU, NUCLL and UBA;

    b. Chorus' proposed TSLRIC modelling approach would result in excess TSLRIC price/revaluation gains;

       We note Telecom's comment that "Chorus' line of argument effectively requires the Commission to apply a rate of return approach to a revalued version of Chorus' legacy network. It misconstrues the purpose of a TSLRIC exercise and price, and renders the use of a TSLRIC pricing principle meaningless".[13]

    c. TSLRIC price determination is not limited to modelling a network based on Chorus' existing service. (The service definition used for the TSLRIC modelling/selection of MEA does not have to have the same service functionality as Chorus' copper services or that required to meet TSO Deed obligations.);

    d. The MEA is not necessarily copper;

    e. The Commission could apply multiple technologies for the MEA (consistent with overseas precedent);

    f. The MEA ultimately needs to be determined by cost modelling to determine what is lowest cost/most efficient;[14] and

    g. The Commission's process is too rushed and will result in flawed/excess TSLRIC prices to the benefit of Chorus only (we consider this to still be a valid concern despite the improvements to the Commission's consultation process since the last consultation).[15]

Service definition for MEA/TSLRIC modelling does not need to have the same functionality as Chorus

51. As noted above, there is general agreement, other than Chorus, that the service definition should be in terms of core functionality.

52. Network Strategies point out that "Contrary to Chorus' assertions, there is no evidence that regulators insist that the MEA must replicate exactly the full functionality of the legacy network. Regulators typically define the MEA in terms of reflecting the same or

---

[12] Refer to the section: The Commission needs to take relativity into account in terms of how to apply TSLRIC.
[13] Telecom, Telecom, cross-submission, UCLL and UBA FPP: further consultation and supplementary paper, 30 April 2014, page 3.
[14] Refer to the section: Ensuring decisions are evidence based.
[15] Refer to the section: TSLRIC FPP determination process is still too truncated.

similar service potential as existing assets".[16] Network Strategies' go on to point out that the approach taken by Ofcom, International Regulator Group, and the Danish regulator is an emphasis on lowest cost rather than consistent statements about functionality.[17]

53. Consistent with Network Strategies' view above, Russell McVeigh state that "the MEA need not (as a matter of law) replicate the full functionality and facilities of the existing service, nor is it required to do so. We do not interpret the definition of TSLRIC as placing constraints on the choice of MEA above and beyond what typically apply under a TSLRIC exercise".[18] This view is reinforced by the Wigley & Associates[19] and WebbHenderson[20] legal advice.

54. Vodafone also point out that "The costs of any adjustment required by changes in service functionality of the type referred to in Chorus' submission will not, in reality, be borne by Chorus. Any costs will be incurred exclusively be end users and/or retailers. For example, the cost of replacing or resolving configuration with DSL modems, SKY set-top boxes, security alarms etc … these are decisions and costs that Chorus has no involvement in. Accordingly, we do not understand why it would be necessary to include in a TSLRIC model the costs of measures that would enable an MEA to provide the functionality of the relevant service …"[21]

55. We also agree with the Commission that the Chorus and Analysys Mason view that the Commission is "required to model a network that can deliver the full functionality of the UCLL STD service and that the only technology that can do so is the existing copper network" is "a strained interpretation of the Act, from a forward-looking perspective" and that "low speed data services such as alarms and facsimiles are services based on legacy technology. These services reflect historic technology choices that have been made. Alarm devices could be adapted relatively easily to work over IP (broadband) or GPRS (cellular) networks. Although existing fax services will not work over most VOIP codecs (coder-decoders), the modern equivalent of a facsimile is an email attachment".[22] The Chorus' position would be akin to arguing that if a new railway network was built today it should be built with narrow gauge train tracks to accommodate old trains, even though this would preclude the introduction of 'bullet' train services. This may be another reason for concluding Chorus is far removed from being a hypothetical efficient operator.

Choice of MEA needs to be based on cost modelling to determine least cost/most efficient options and not tied to Chorus' existing network

56. MEA options are not tied to Chorus' existing network.

---

[16] Network Strategies, Cross-submission on UCLL and UBA TSLRIC further consultation paper, 30 April 2014, page 1.
[17] Network Strategies, Cross-submission on UCLL and UBA TSLRIC further consultation paper, 30 April 2014, page 3.
[18] Russell McVeagh, advice to Telecom, UCLL and UBA Final Pricing Reviews, 30 April 2014, paragraph 4(c).
[19] Wigley & Associates, UBA AND UCLL FPP Price Review Determinations – Memorandum for Cross-submissions on behalf of Orcon, 30 April 2014.
[20] WebbHenderson, Memorandum of advice, UCLL and UBA Price Review – Selection of an Appropriate MEA, 29 April 2014.
[21] Vodafone, Cross-submission on further consultation papers on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle, 30 April 2014, paragraph B3.3(c).
[22] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 157.

57. As InternetNZ notes "It seems to use an absurd notion that the Act would be written or intend that a competitor, real or hypothetical entering the market would deploy a new network identical to the existing network which was built 50 years ago to provide an entirely different service (voice) …"[23]

58. **Wireless is a MEA option:** CallPlus, Orcon, Telecom and Vodafone all support use of wireless as part of the MEA (including use of a fixed wireless cap, as was used in the TSO cost determinations).

59. Chorus are factually wrong to claim "the international precedent referred to parties, once put in context, does not support a fibre and wireless MEA".[24] Network Strategies' report demonstrates this conclusion requires an extremely selective review of international precedent.

60. **More than one MEA needs to be considered:** Chorus' is half wrong to suggest "The Commission should cost only its one cheapest MEA".[25] Only half wrong because the Commission should cost its cheapest MEA. But wrong that the Commission should cost only one MEA. Chorus' position is contrary to the determination of the Supreme Court in the Vodafone TSO case, which determined more than one MEA should be used (including wireless) for determination of the incremental cost of an efficient service provider.

61. **Modelling is required to determine least cost option:** Telecom assert that "We agree with Chorus that a copper or fibre MEA may not make much different to cost as they likely share similar civil engineering costs".[26] This needs to be tested by cost modelling and should not just be assumed. All submissions other than Chorus argued the Commission needs to undertake cost modelling to determine the least cost/most efficient MEA(s).[27]

62. While Chorus complains multiple MEAs would be complex, Network Strategies points out that "The Swedish model provides a particularly relevant precedent for the Commission, showing that it is feasible for a single LRIC model to accommodate multiple MEAs to derive costs for unbundled local loop and bitstream (both copper and fibre). This model uses fibre and radio as MEA for copper … This facilitates the lowest cost technology choice, and is entirely consistent with the practices of an efficient operator deploying a network in current market conditions".[28]

---

[23] InternetNZ, InternetNZ Cross Submission: Further Consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the Final Pricing Principle, 30 April 2014, page 6.
[24] Chorus, Cross-submission in response to the Commerce Commission's Further consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle – Consultation Paper (14 March 2014) and Supplementary Paper (25 March 2014), 30 April 2014, paragraph 2.2.
[25] Chorus, Cross-submission in response to the Commerce Commission's Further consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle – Consultation Paper (14 March 2014) and Supplementary Paper (25 March 2014), 30 April 2014, paragraph 20.
[26] Telecom, cross-submission, UCLL and UBA FPP: further consultation and supplementary paper, 30 April 2014, page 3.
[27] Refer to the section: Commission decisions must be evidence-based.
[28] Network Strategies, Cross-submission on UCLL and UBA TSLRIC further consultation paper, 30 April 2014, page 2.

TERA provide useful guidance on a number of matters

63. We consider that the TERA[29] expert report provides some useful input into some of the technical choices/decision the Commission will have to make in the TSLRIC determination process, subject to the substantive qualification that the Tera report is incomplete as it only reflects pre-2014 consultation and submissions.

Positive observations from the TERA expert report

64. We agree with TERA on a number of substantive points which we detail below:

    a. "The choice of MEA is directed at determining the efficient cost today of an equivalent service unconstrained by the historic technology choices of Chorus."[30]

    b. “An adjustment may be made to the MEA technology in order to reflect that the modelled technology is different from the current regulated copper technology. … Such adjustment is recommended by the European Commission …"[31]

    c. "For new assets, the bottom-up approach is the most suitable approach. Because the chosen approach must be forward-looking, the bottom-up cost standard is the most suitable approach to model those assets that should be rebuilt".[32]

    d. "For third parties’ assets (like electricity poles), we do not recommend using a bottom-up replacement cost, but instead using the price of access to these assets that can be charged, for example, by the electricity company. In fact, an efficient operator would not rebuild these assets but would prefer to rent access to them. It is clear from FTTH deployment around the world that such a practice is common".[33] Relevant evidence is the arrangements of Enable and other LFCs, Vodafone’s cable network in Wellington and Christchurch, deployed using Wellington Electricity and Orion’s networks, and the network sharing plans of unsuccessful EDB UFB bidders, such as Vector.

    e. "Valuing ducts on a replacement cost basis (bottom-up basis) may generate over compensation, as argued by some respondents".[34] We do not agree that "this issue is not directly relevant in the New Zealand context since prices should be set on the basis of forward looking TSLRIC costs".[35]

---

[29] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014.
[30] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 8.
[31] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 40.
[32] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 51.
[33] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 51.
[34] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 51.
[35] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 51.

f. "If UCLL and UBA do not have the same MEA, double recovery should be identified and removed".[36]

Legal framework as to consultation, dealing with submissions, and giving reasons

65. Under s 52 of the Telecommunications Act, the pricing review determination must include "the reasons for the pricing review determination".

66. In addition, the draft pricing review determination must include the reasons for the draft. (Section 49). The Commission must consult on the draft (s 47 and 50).

67. These provisions of themselves do not require draft reasons, final reasons and submissions before the draft pricing review determination. Those are steps that have not yet occurred.

68. However, by deeply entrenched and valuable practice of the Commission in telecommunications matters over many years, there is an extensive history of consultation earlier in the process, by way of consultation papers. This, at least, creates a public law legitimate expectation that the Commission will consult and approach the matter on a similar basis.[37] If the Commission does not consult correctly and deal with submissions correctly, that may be reviewable breach.

69. There may be additional public law sources of comparable obligations to consult, deal with submissions, and give reasons, which we don't deal with here as in our view it is sufficient to know that there are statutory and legitimate expectation considerations.[38] For similar reasons we have not overly analysed any possible differences between the required standards as between say the Act's requirements and legitimate expectation such as the question of what constitutes adequate reasons. Implicit for example in the need to give reasons under the Act is that the reasons must be adequate: any old approach to giving reasons will not work. The level of reasons required is an important issue and we return to that below. We simply note at this stage that one of the better summaries as to public law requirements as to reasons is the chapter on reasons in Matthew Smith's text on Judicial Review (Chapter 60).

70. There is another source of public law risk arising out of consultation processes including as to considering submissions and giving reasons. A failure at the pre-draft PRD stage may be evidence that there is error in the process that is appealable or reviewable. A common example is that the Commission often makes decisions or draft decisions at an earlier stage that effectively become final by the end of the process in the PRD (eg because they are incorporated in the final decision by cross reference or by inference).

---

[36] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 74.

[37] The leading NZ case on the need to give reasons, Lewis v Wilson and Horton [2000] 3 NZLR 545, cites an English example of legitimate expectation before a tribunal: R v Civil Service Appeal Board ex p Cunningham [1991] 4 All ER 310 but legitimate expectation examples abound.

[38] For further detail on other avenues see Smith, NZ Judicial Review Handbook at 60.2.2 to 60.4

If for example, in that process, the Commission does not refer to a major submission put forward by the party, and outline the reasons why it rejects the submission, that is evidence that the Commission has not considered adequately that submission and has thus fallen into reviewable error. Even if it has in fact considered the issue but simply omitted to deal with it in the decision documents, including such documents before the PRD, there may well be reviewable error.

71. Thus there are other potential sources of judicial review and appeal exposure if there is inadequate consultation, consideration of submissions and giving reasons. This breadth of risk is conveniently observed in Bell v Victoria University (footnote omitted but it is a citation of Taylor's text on Judicial Review):[39]

> "It is well established that, where there is a duty to provide reasons, "[a]n inadequate statement of reasons is a reviewable error." Therefore, if the DAC's reasons were inadequate there would be an error of law. It is also well established that adverse inferences about a decision making process can be expected to follow where an inadequate statement of reasons is provided. As a matter of law, therefore, a failure to provide adequate reasons can be a ground of review on its own, or can for example that relevant matters were not taken into account or that irrelevant matters were taken into account"

Can an error be fixed later, such as in the PRD process?

72. Often, an error as to consultation earlier in the process can be remedied later, such as correct consultation at the draft pricing review determination stage. That would need to be carefully done to be effective.

73. In this instance – the FPP process - there is a major and possibly fatal impediment to fixing an error at a later stage on this PRD, as has already been observed. On many decisions, particularly with the Commission's self-imposed time lines – which are still too tight by a substantial margin - it will be too late to change track later. Key modelling decisions will be irreversible. The modelling will have got too far down the track to have any real prospect of change. Subsequent consultation inevitably cannot be open minded consultation in that situation as there is little or no choice by that stage the decision having been made in reality earlier than the draft PRD. A litigant will likely have no difficulty, by OIAs etc, in framing the evidence for this. The Vodafone and Telecom TSO Supreme Court decision shows just how far the court will go into facts even on a Telecommunications Act error of law appeal. It will do so on a judicial review too.

74. The starting point on this is the reality of how big this project is and how decisions would need to be made early on which would not be reversible without considerable delay. Paragraph 5 of Orcon's 30 April cross submission listed some of the apparent deficiencies in what is happening, demonstrating the problems. While there have been some information requests since, there has been little sign of change to the issues: to the contrary. For example, mobile has been dismissed as a MEA, despite submission not referred to the contrary, when it is difficult to understand why that can be justified. That approach is consistent however with not departing from the approach to MEAs the

[39] Bell v Victoria University HC Wgtn CIV-2009-485-002634 8 December 2010, Clifford J, at [76].

Commission seemed to commit itself to early on (as evidenced by the lack of relevant information requests).

75. This problem can be framed in a number of ways, including as a breach of natural justice, pre-determination, and breach of the duty to consult and give reasons.

76. The remedy available where no or insufficient reasons are given can be both by appeal for error of law, and for judicial review.[40] It is an error of law, and not just a judicially reviewable error, as:

    a. The Act requires that reasons are given;
    b. Those reasons must be sufficient;
    c. If reasons are not given, or they are insufficient, that is a breach of an obligation in the Act;
    d. That is an error of law.

77. In those circumstances, an error in consultation and decision making earlier on may be an appealable or reviewable error of law which cannot be fixed later.

78. The problem is further compounded because the appeal rights arise only after the final determination. Also, most public law and judicial review remedies are available only after the final determination is made. For example, declaratory judgement is available in only limited instances during the process. Therefore, an aggrieved stakeholder generally has to wait until the determination has been issued, leading to the obvious risk that the Commission must start over the process again, when that could be avoided.

79. One practical remedy of course is for the stakeholder to raise the concern at the time by way of submission, but it has been surprising how often those raised concerns are not then dealt with by the Commission even when strongly raised. This is in our experience a major feature of the telecommunications processes, with plenty of examples.

Summary so far

80. For that and pragmatic reasons such as getting it right first time, we submit that the Commission ought be particularly careful to get the consultation and consequent decision making right at each stage. In a matter such as this there is always the risk of appeal and judicial review given the issues at stake. But there is much to be done to reduce that risk, and/or to at least confine appeal and review risks to what cannot be avoided.

81. Additionally, the courts, as noted above, have made it clear that a well-reasoned decision, following a sufficient consultation process, in which parties submissions are adequately handled, will mean that the courts will give that decision greater deference so that there is less prospect of intervention.[41] The positive aspect of this for the

[40] For a recent example of this see Bell v Victoria University HC Wgtn CIV-2009-485-002634 8 December 2010, Clifford J, at [76].
[41] See for example Smith at [60.4]

Commission is that getting this right will strengthen the decision making and lead to the courts being loath to intervene on appeal or judicial review.

82. We have detected a substantial history of the Commission over the years, and increasingly so, not sufficiently addressing parties' submissions and sufficiently giving reasons for decisions, in a manner that is appealable and/or reviewable. Leaving aside the legal issues, we have also seen this raise considerable concern among stakeholders, whether access seeker, access provider or other stakeholder. Put another way, parties can be left with the sense that their case has not been heard, and that leads to disillusionment, and in turn avoidable action. Our impression over the years is that many parties tend not to raise concerns on a "Don't alienate the Commission" basis. Indeed, our impression is that there is a surprisingly strong focus on that approach. However, that submerged iceberg, we believe may well come to the surface after a determination has finished, as that relatively quiet party decides its best alternative is to litigate. In other words, this is a greater risk than appears at first sight.

How does this relate to the FPP?

83. A recent example of the apparent problems is the absence of dealing with strong points raised by parties on the UBA IPP Update Paper around the "evidence" (which was close to non-existent) and analysis underpinning the s 18 analysis. This example is given because the FPP paper – surprisingly in our view - builds on that update paper and the conclusions drawn from it, further compounding the problems. It comes close to simply adopting the IPP Update conclusions which were so heavily criticised. (There is in addition the concern that such an approach cannot be taken on an FPP even if it could be taken on the IPP, although even the latter in our view was not legally available).

84. Against that background, the FPP framework paper has a substantial number of deficiencies of approach which help neither stakeholders nor the Commission, in terms of consultation, draft reasons, and dealing with submissions. As noted above, this can be rectified but if not rectified quickly, most issues, due to the time pressures and need to commit to a path, become irreversibly reviewable errors and/or errors of law.

85. Absent change, it seems likely that parties will seek appeal or review. If we are seeing issues and concerns from our clients' perspective, we would be surprised if Chorus and other parties don't have their own set of overlapping concerns, even if they don't articulate them at this stage.

86. All that is avoidable.

87. We have set out the main but not all concerns in tabular form to aid with the focus. We invite the Commission to address each of the identified issues in light of these observations. Or, to be clearer, we consider that the handling thus far of those issues involves reviewable error unless remedied.

How to remedy?

88. Generally we have suggested that the Commission re-consult with more developed material, as it will be too late to do that later (and/or there would be other problems, whether legal or in terms of stakeholder concerns (the "optics")). That is not the only way to deal with this: there might be a more pragmatic approach that fits with other steps. For example, if, as seems to us to be essential (just as other regulators see as essential), the Commission consults on a draft Model Reference Paper, that could be the time to do this. (The current paper is essentially a high level model reference paper and so does not go into sufficient detail as yet: certainly it is well short of the sort of model reference paper developed under international best practice and the Commission takes a real risk in taking steps short of that practice).

89. To be clear, the FPP framework paper is only part way through the process and some of the issues might be intended to be handled at another point. There is a net effect to consider although, at least the optics of what is happening on the points is not optimal. All things equal, we think the issues identified are already problematic. Put another way, the prospect that some of these issues can be sorted or would be sorted later ought not disguise the underlying problems.

90. However, the wider concern is to invite the Commission to get its processes improved overall, not just as to the issues in the table or on this FPP.

The FPP markedly increases the Commission's obligations

91. IPPs and other Part 2 processes such as FPP have overlapping consultation obligations including as to giving reasons. But the FPP has materially higher obligations than for IPPs. That flows from the intended "quick and dirty" nature of the IPP, as it is designed to be a quick yet blunt proxy for the FPP. The overall process, the evidence, the consultation, the reasons given and the handling of submissions, are markedly ratcheted up relative to IPP requirements. There is a big difference in required approach. (This of itself raises concerns around the speed of the FPP process relative to its IPP forebear). What could be done for the IPP can no longer be done at the FPP stage.

92. To take an example, the evidence required to support application of s18 considerations is substantially higher for FPP than in relation to IPP. In our view the evidence and analysis on how s 18 is applied is short of what is required, by a large margin, in both the IPP and the FPP. As to the FPP, we develop the legal requirements below. We note also that the Commission, in the FPP framework paper has ignored submissions made as to the level of evidence that is required.

How must the Commission deal with submissions and give reasons?

93. As noted above, we won't go into detail on any differences between obligations such as under the Act and by way of legitimate expectation. From Mathew Smith's chapter on reasons in his NZ Judicial Review Handbook, there is in any event a broad alignment of approach.

94. We note at the outset that the obligation to consider submissions and evidence, and give reasons does not require War and Peace. It does not require reference to minutiae. However, here we are dealing with major issues with substantial impact on the price, where the handling has been minimal or non-existent. The handling must be sufficiently comprehensive.

95. Any requirement to give reasons, whether under the Act or public law, requires the reasons to be sufficient. Any old level of reasons won't do.

96. The need to give reasons is guided by principles set out mainly in *Lewis v Wilson and Horton* [2000] 3 NZLR 546 (CA), and in other authorities collated in Smith, such as:

    a. Openness of administration of justice and maintenance of public confidence;

    b. To improve and ensure the quality of decisions. For example*: Potter v NZ Milk Board* [1983] NZLR 620, 624: *"the giving of reasons helps to concentrate the mind of the Tribunal upon the issues for determination"*); Garratt v Police[42]: *"the very act of articulating reasons is an important part of the reasoning process and is…an antidote to arbitrariness in decision-making."*

    c. To attract some deference on appeal/review (as outlined in cases stated by Smith at [60.1.4]).

    d. To avoid adverse appeal/review inferences

    e. To assist the parties and the court on further appeal/review.

97. That last point is particularly relevant here. For example, Barker J has observed[43]

> "Lack of reasons frustrates the unsuccessful party's appeal rights… If the reasons for the award are not stated, then the Magistrates' Court, on appeal, or this Court on motion for review, does not know whether all necessary considerations have been taken into account."

98. In another case Barker J noted [44] as Smith notes, that where the statute expressly required the Council to provide reasons, and there was a right of appeal from the Council's decision, the Council was under a duty "to make such findings or express such reasons or conclusions as in the particular circumstances are necessary to render the right of appeal effective.".

99. Of course the absence of reasons does not make any review or appeal unavailable: the outcome will be a successful appeal (for failing to provide adequate reasons as required by the Act) or judicial review (see eg Smith at [60.3.2]).

---

[42] HC Rotorua AP32/97 6 June 1997 at 1-2
[43] T Flexman v Franklyn County Council [1979] 2 NZLR 690, 698
[44] Smith v Waikato County Council (1983) 9 NZTPA 362, 366

100. Turning now to what must be contained in reasons, they will need to meet the various objectives outlined above. This will be context specific. Major issues require more detail than minor, and so on. For example, Somers J observed in the Court of Appeal:[45]

> It was "implicit in the rights of appeal conferred by the [Act] that the tribunal of first instance is under a duty to make such findings or express such reasons or conclusions as in the particular circumstances are necessary to render the right of appeal effective."

101. A major part of the obligation to give reasons is to deal with submissions by the parties (see for example the authorities in Smith at [60.7], [60.8] and [60.10]). The decision maker does not have to deal with all submissions but it must deal with principal points. As Smith notes at [60.7.1], quoting various High Court cases

> "" The duty to give reasons cannot be discharged by the use of vague general words"; "reasons must 'grapple' with the important issues raised".....Reasons should deal "explicitly" with every "fundamental aspect" of a case…Commission's decision "should leave any reasonable applicant with the view that the principal points… have received proper consideration.".

102. There are also obligations as to handling of evidence similar to handling of parties' submissions: see Smith at [60.9] and [60.10]

Legal framework as to required evidence and analysis on an FPP

103. We note at the outset that there have already been detailed submissions in this FPP process on the need for robust evidence and a robust qualitative analysis. See for example the Orcon and CallPlus submission dated 11 April in this FPP, at [9], cross-referencing and relying on the Orcon submission dated 28 March on WACC. The latter paper is the most comprehensive handling of these issues thus far.

104. However this has been ignored in the FPP framework paper. That is a breach of the Act and public law.

105. Against that background, the purpose of this part of this submission is to update and bring together some of those submissions already made. This does not replace the earlier submissions noted above, such as in relation to the extensive references to the Telstra decision in Australia.

106. As outlined above, the required approach for an FPP is markedly more robust and more detailed than for an IPP.

107. This extends to the robustness of the evidence that the Commission must rely upon, and the robustness of the analysis of that evidence.

108. This is the first occasion for some time that the Commission has moved beyond the "quick and dirty" arena of interim decisions and the like (such as IPPs) onto more major

[45] R v MacPherson [1982] 1 NZLR 650, 652

and final decisions. The approach of the Commission established over time is outlined in the 2003 unbundling decision.[46]

> The Commission considers that it is required to attempt so far as possible to quantify detriments and benefits … This is not to say that only those detriments and benefits that can be measured in monetary terms are to be included in the Commission's analysis[.] Those of an intangible nature, which are not readily measured in monetary terms, must also be assessed.

109. Using the s 18 analysis as an example, the FPP is currently minimally based on fact, and only minimally undertakes an efficiency analysis of the type that the above decision would require. Thus, the Commission is departing from its established practice. The earlier final decisions such as this are the precedent and not the approach as to IPPs. That is an error.

110. Authority also supports this view. As Richardson J observed in the Court of Appeal in Telecom v Commerce Commission (when dealing with clearances but the principles would apply here too), where he said, in relation to the Commission:[47]

> … the desirability of quantifying benefits and detriments where and to the extent that it is feasible to do so…there is in my view a responsibility on the regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.

111. Thus, the Commission cannot apply s 18 based on assumptions (eg that dynamic efficiency trumps static) or on economists' reports largely unsupported by evidence. For example, a decision to take into account investment in new networks such as under s 18(2A) must be underpinned by evidence and a quantitative cost benefit analysis. At present the proposed approach is close to the decidedly rudimentary analysis on the IPP (which was inadequate for the IPP and is clearly so for the FPP).

112. It is worth pointing out that these criticisms and possible errors of law are not about *Edwards v Bairstow* concerns as to adequacy of evidence: that error of law is based on there being no probative evidence. The ground instead is that the law requires fulsome evidence and it requires fulsome analysis such as a quantitative CBA. To not do so is an error of law. That is separate from the *Edwards v Bairstow* ground.

113. We note in any event that the Vodafone and Telecom TSO Supreme Court decision shows how far, on appeals as to errors of law on an absence of probative evidence basis, the courts will enter complex factual territory. Given that the appeal against the Commission succeeded as it wrongly discounted mobile as a MEA for TSO, it is ironic, and concerning that:

a. Mobile is rejected in the FPP framework paper;
b. There is little evidence and analysis on the point;

---

[46] Paragraph 75 of the Commerce Commission's "Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network - FINAL REPORT", December 2003.

[47] [1992] 3 NZLR 429 at 447. That decision has been applied in authorities such as *Godfrey Hirst NZ Ltd v Commerce Commission* (2011) NZBLC 103,396

c. Submissions as to why it should be a component in the MEA have been ignored beyond minimal reference;
d. These points as to the implications of the Supreme Court case have been specifically raised in submission but they have been ignored;
e. For example, the passages quoted from the Supreme Court at [7] of Orcon's 30 April submission have been ignored, despite the Supreme Court's strong guidance in this area in those passages;
f. The Supreme Court decision shows how far the courts will intervene on factual matters on error of law appeals and the Commission appears not to be following the judgment;
g. The very subject of the Supreme Court case has again not been accepted, for little apparent reason, yet the Commission has been down this path before on this same issue, all the way to the Supreme Court;
h. Concern had been expressed earlier that the failure to deal with mobile and to deal with it sufficiently, when it was so squarely on the table, implies that the concerns are more widespread, where issues had not been raised so obviously such as in the Supreme Court decision as to mobile.

114. As an example of the approach to evidence and its analysis, sufficient evidence and analysis is required to choose between the various MEA options. That has not happened. The Commission does plan to cost the differences between Fibre and copper MEAs for UCLL, but:

a. That is not an option for UBA given the Commission has decided in draft (without reference to 3 pages of submissions to the contrary) that only a copper MEA is legally available for the UBA uplift;
b. It appears that the Commission is not going to do a copper and FWA comparison for more remote connections (and anyway mobile is not going to be costed);
c. It seems (but the paper is ambiguous on this) that FWA will only be used over the RBI footprint. In other words rather than optimising to see what the most efficient network is over the DSL footprint, the Commission will only use the historic network.

115. The FPP framework paper is ambiguous on where the service being modelled starts and ends. It can be interpreted as ending at the boundary between the DSL and the RBI footprints. Or it can be interpreted as including the RBI. Either way this ambiguity is problematic and needs to be resolved.

116. If the RBI footprint is included:

a. RBI is almost always outside the DSL footprint, and thus does not fall to be modelled, if the Act is applied correctly. The DSL footprint is being priced, as outlined in earlier submissions. That is implied from the Act as to UCLL. It is expressly stated as to UBA.
b. Thus, if RBI is in theory being used, that is irrelevant, pointing to error if this scenario applies.

117. If the RBI footprint is not included, the position is just as confusing:

a. The paper reads as though FWA will be considered only over the RBI footprint but that is outside the DSL footprint;
b. It is hard to see how RBI would be relevant.

118. It is difficult to understand, why, instead, the Commission is not proposing to optimise the network modelling, by looking at having FWA in the MEA where, over the current DSL footprint, that is the least cost-option. It may be a cost analysis would show that many connections currently served by DSL would be served at least cost by FWA.

119. Then, adding mobile back in as an option – which is excluded for no apparent reason and contrary to submissions and the Supreme Court judgment – many connections might be served at even lower cost via mobile.

120. Notably on that point, three MNOs already have infrastructure that the hypothetical operator could lease to provide those mobile services. Just as the Commission has – correctly – concluded that electricity company poles can be leased and included in the modelling, existing MNO services are available and should be included in the modelling. Leasing cost is likely to be cheaper due to competition between the MNOs to lease the services and equipment.

121. To do otherwise would be inconsistent as this is all third party assets. In this regard, we note also that it would be inconsistent not to factor into the modelling the availability of ducting from the non-Chorus LFCs. (See [146] – [149] in the FPP framework paper). The fact that regulated access to ducts is not available is not a reason to do this, nor is the fact that there is complexity a reason against. The Commission is required to, and can, estimate the likely charges for such services. It can do that. In any event, it can and should model on the basis that regulated access to ducts can be sought and obtained. This is a forward looking model and so the Commission must hypothetically assess what is possible and/or likely.

122. Returning to the authorities, we now have the IM judgment which further reinforces why sufficient evidence and analysis is required. Notably, this decision by the Judge and two expert lay persons is parallel with a similarly robust decision requiring evidence from the Australian Competition Tribunal in relation to pricing of Telstra services. The Tribunal there also comprises a highly experienced judge and two experts in the field. Our earlier submissions deal with that decision too.

123. The different evidential and analytical approach as to WACC in the FPP and Part 4 Commerce Act, in the process following the High Court's criticism, now starkly illustrates the problems:

a. Following detailed analysis, the Part 4 WACC at draft stage is reduced from 75th to 67th percentile (that is, light analysis and evidence produced the 75th; more detailed evidence and analysis produced the 67th).

b. Absent such detailed analysis, it was not likely in our view that the Commission would have so reduced uplift for UBA and UCLL WACC (we accept it may do now

that the Part 4 paper has come out). The same would likely not happen as well with other adjustments of the components in the UBA and UCLL price.

c. WACC percentile uplift is one of the smaller ingredients in the UBA and UCLL price. But the numbers involved are still large. With an asset base in the order of $11.9 Bn for electricity, assumed asset base for the hypothetical telco operator of $4Bn, and impact on prices for electricity leading to a drop in revenue of around $30M, this implies a drop for UBA and UCLL from the 75th to the 67th of around $10M per annum. That's around $50M over the regulatory period.

124. Of course there are assumptions in that calculation, particularly as to the telco asset base, but on any basis, the figures are large. This makes clear that, even on these relatively small items, substantial and robust evidence and analysis is required, for the Commission is deciding very large numbers that amply justify a robust approach.

125. An example of a larger variation as a result of Commission choices is as to the fibre and copper MEA:

a. The UBA uplift if there is a fibre MEA, absent adjustment, is in the order of a dollar (based on the TERA analysis for Denmark and because the lit fibre component of fibre is a miniscule part of the fibre stack);

b. The UBA uplift if there is a copper MEA is far more, absent adjustment: the starting point is the IPP of $10.92.

c. The UCLL component is the same in both scenarios, more or less. Thus the difference caused by UBA MEA choice (around $10) is huge.

126. This implies a need for robust evidence and analysis around the choices made. There are many decision points in between the small (eg WACC uplift) and the big (eg choice of MEA). Of course the example above is relatively simplistic but it correctly applies a principled approach and even if the gap between the two price points is half, it is still a $5 difference, and that is huge.

127. Returning to the IM judgment, the case continues and adds to the authorities pointing to the legal requirement to have robust evidence and analysis, and cannot simply be dismissed as factual observations in the context of legal requirements under the Act, and error of law considerations.[48]

128. The High Court (a judge and two highly experienced lay members) criticised the Commission's WACC 75th percentile decision as being based on assumption and for treating the need for an uplift in WACC as "axiomatic".

129. One of the recurring themes from the Part 4 IM Merit Appeal decision was the importance of ensuring evidence-based decisions.

[48] That is so even though the High Court last week refused leave to appeal to the Court of Appeal.

130. For example, the High Court observed:

> Vector's failure to provide any evidential explanation … is a major weakness in its argument.[49]
>
> Where a proposition is simply asserted by economic experts, we give it little or no weight.[50]
>
> … we are not prepared to assume … that regulated suppliers have, in fact, suffered accounting losses to date.[51]

131. The High Court view on the WACC percentile matter that inadequate evidence had been provided to justify 50th percentile, 75th percentile (the status quo) or higher:

> No supporting evidence was provided by the Commission. Indeed, the propositions advanced … seemed to be considered almost axiomatic.[52]
>
> These in-principle objections to deliberately erring on the side of overestimating the WACC, however, suffer from the same lack of empirical support, at least in the materials before us, as the Commission's approach.
>
> The onus is on MEUG to persuade us that applying a mid-point WACC estimate would lead to a materially better IM. While MEUG's in-principle arguments cast significant doubt on the Commission's position, it did not present any positive evidence of the type we refer to above, for example an inter-sectorial analysis, in support of its proposal. We are therefore unable to be satisfied that the IM amended as MEUG proposes would be materially better in meeting the purpose of Part 4 and/or the purpose in s 52R.[53]

132. Particularly significant is the High Court's dismissal of the Commissions' frequent mantra, without any supporting evidence, that dynamic efficiency trumps static efficiencies. Despite this, the Commission on UBA and UCLL is still persisting in taking the same approach.

133. On this the High Court said in the IM judgment:

> [1462] No supporting analysis was provided by the Commission. Indeed, the propositions advanced for choosing a point higher than the mid-point seemed to be considered almost axiomatic. This extended to a strongly expressed, but unsupported, view of the benefits of dynamic efficiencies deriving from investment, without apparent regard to the nature of the investment. Such a sentiment is evident in the passage quoted in [1396] above, especially the nexus assumed between dynamic efficiency and incentives to invest. Nor was there any reference to how the outcomes produced by workably competitive markets might be relevant.
>
> [1474] If dynamic efficiencies are, as the Commission believes, most important, how exactly are higher expected returns supposed to stimulate them? Dynamic efficiency implies finding better ways to meet customer needs and adapting to changes in market circumstances. But necessity, not plenty, is the mother of invention.

---

[49] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1513].

[50] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1745].

[52] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1462].

[53] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraphs [1482] and [1483].

134. These statements reflect that the Commission should ensure its decisions are based on analysis and evidence based to the extent practicable, and the Commission should not just rely on assumption or treat a position as axiomatic. This requires, for example in the case of the s 18 efficiencies analysis, proper evidence and a quantitative cost benefit approach. It requires a similarly robust evidential and analytical approach on all other significant issues as well. It disallows any reliance on an assumption that dynamic efficiencies trump static.

135. In the IM case, the appellants failed as they also had not adduced the evidence. But it does not at all follow from that, that in this UBA and UCLL FPP the Commission can lawfully develop its position without proper evidence and analysis. It is required to obtain and provide sufficient evidence, analysis and reasoning.

Legal considerations as to application as to s 18

136. These have been dealt with extensively in earlier submissions, in the High Court, and in the Court of Appeal. Additionally s 18 issues are dealt with above. The position will not be repeated except that is useful.

137. We rely in particular on our s 18 submission to the Court of Appeal, which are provided with this submission.

138. Although the argument can be framed in different ways, our primary submission here, as in the Court of Appeal, is encapsulated in the following proposition (this is modified slightly):

> The Commission must initially make it decisions as to cost and price, including on difficult judgment calls, only based on cost attributes or other objective evidence independently of efficiency attributes. Only if and when it reaches a point where there is a range of viable choices to estimate price or make the particular choice – a plausible range – should the Commission use s 18 and efficiency attributes to help make the choice from the plausible range.
>
> "Cost attributes" comprise, solely, cost evidence and analysis. "Efficiency attributes" comprises solely efficiency evidence and analysis.

139. In the framework paper, the Commission says at [56]:

> > "Our purpose in making the determinations is first and foremost to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand."

140. That is not correct and essentially elevates sections 18 and 19 beyond what is permitted by the clear structure of the Act. Sections 18 and 19, as more fully explained in the Court of Appeal submission, can only apply where the IPP cost definition permits. Critically, the Commission's "purpose in making the determinations is first and foremost to….", instead, decide prices based solely on cost evidence and analysis. Promotion of competition is irrelevant to that process. Promotion of competition is only a – hopefully – consequence of setting the cost price, not a factor in deciding the price (unless and until a plausible range is reached.

141. That error appears to be reflected in the application throughout the paper of s 18 factors at multiple points. But the Act does not permit that triffid like growth. It also

does not permit the unclear application of s 18 when there must be clarity of when it is being provided. Efficiency analysis (s 18) is very different from cost analysis (the IPP description is strictly limited to cost).

142. Just as in the IPP, the great majority of judgment calls can and should be made solely on cost evidence.

143. When the need for underlying evidence and quantitative analysis is added, the need for clarity becomes even clearer.

144. The Commission must make all judgment calls based on cost evidence and similar empirical non-efficiency evidence (eg as to choice of MEA). Only if there is a plausible range can the Commission resolve the impasse via s 18.

Application of s 18 law to the FPP

Introduction

145. Remarkably, after: the unusually strong concerns expressed around the IPP and the handling of the Update paper as to the handling of s 18 when clients were driven to write firmly to the Commission; after other steps on the IPP such as the conference in relation to s 18; after the multiple times when the relevance and application of s 18 has been submitted upon on other occasions; after the Commission's involvement in the High Court proceedings where our clients' s 18 arguments were central for them; and after s 18 submissions were strongly made in this FPP process: there is a total failure in the FPP framework paper to deal with those submissions. To the contrary, the Commission only cites and relies upon contrary submissions that support its position.

146. This is remarkable, given the history. The Commission could not avoid knowing just how important this issue is for clients. In light of the analysis above as to consultation and reasons, this is the clearest of errors. This history cannot be described in any way other than as extraordinary. It is certainly frustrating. Sadly this failure to refer to submissions in the FPP framework paper is not alone, in relation to other submissions of high relevance to the FPPs. What is clear is that these failures are so substantial that the current process is flawed and at high risk of being overturned unless rapidly fixed. Moreover, the various concerns raised in this submission affect multiple fundamental elements in the FPP framework paper, and therefore there are multiple consequential implications. There is not much in the FPP framework paper that is not affected by the fundamental problems.

147. It is frustrating and embarrassing that, on such readily apparent points, we are forced to submit so strongly, but the Commission has given no choice in this. It is hard to think how these concerns could have been notified to the Commission in a clearer way.

148. Of particular concern is that the failure to deal with this obvious issue – and other obvious issues noted in this submission - points to wider problems submerged under underwater for this iceberg. What is so concerning is that, on the upfront and obvious

material, there have been these errors. The risk for the Commission is that these issues will come out of the water later and turn into legal problems.

149. To be clear about the concerns:

a. It is not only about whether the s 18 is right or wrong: that is a matter for the Commission, but it is generally an appealable matter as it is a legal question and we say that the Act does set out the required approach as submitted;
b. It is also about the Commission considering submissions, and dealing with them in the draft and final documents, as the Act and public law requires. Section 18 is a big issue on the FPP (in our view, the biggest) and it must be given commensurate focus.
c. Once the primary s 18 conclusions are addressed, the consequential draft conclusions will need to be revisited.
d. For example, when the incorrect conclusion that TSLRIC "objectives" include dealing with s 18 (when TSLRIC objectives are solely about deriving the cost, as that is what the Act says), the decisions on many matters in the FPP framework paper will need to be revisited.
e. An example of this is that the choice as to pricing in relation to Chorus's existing assets – a particularly large issue on the FPP - is strongly influenced by a relatively loose and brief application of s 18. That will need to be readdressed after proper consultation on an adequate draft decision, taking into account the s 18 issues that have been raised, and taking into account also the evidence and analysis submissions flowing from the cases and the Commission's existing practices as in the original decision not to regulate UCLL.

150. The need to revisit this could easily have been avoided, as could the need to make this submission have been avoided. Similarly, the overlapping need to go back to the drawing board around sufficiency of evidence and the need for quantitative analysis (plus other issues) – on which again the clear submissions have been ignored – could have been avoided.

151. We will deal with the Commission's approach first, starting with dealing with a simple example of error, and then we will turn to the areas where the Commission has not handled our submission. We note that a number of matters in this submission are inter-related. For example, the requirement to gather evidence and undertake a detailed analysis.

An example

152. There are some contradictions in the FPP framework paper. For example [107] gets closer to recognising the legal position as outlined above. But then other parts of the paper depart substantially from this. Take a simple example out of many:

> "203. In considering how to map costs to services, we are guided by s 18"

153. That is not correct (at least, not correct without further context, and the application of that conclusion was not correct in any event). The first questions should be: "How do we map costs to services in order to achieve our objective, which is to decide the cost price? What is the cost-only evidence that we can get?". TSLRIC is about cost, solely. S 18 is about efficiencies, solely. They are two different issues, despite some overlaps as we have noted.

154. Only when and if the Commission reaches a plausible range in answer that question (which will be relatively infrequently, as most such issues can be resolved on cost evidence alone), do the next question arise. "How do we apply s 18 efficiency analysis to choose from the plausible range? Do we do that now or later such as at the end?". This second round of questions are separate. They are efficiency-only questions and that is entirely different from cost-only questions. Misuse of the former departs from the cost-only TSLRIC approach.

155. The approach in the above simple example plays out also in multiple other places in the FPP framework paper.

156. As noted above, the Commission may not agree with that conclusion in due course from a legal perspective (although in our view that is the correct interpretation). But in any event, the Commission must engage with the submission. We turn to that now.

Lack of adequate consultation on s 18 and/or breach of public law

157. The approach underpinning that simple example stems, at least in this framework paper, from the conclusions at [65] in that paper. The Commission refers only to submissions by Webb Henderson, Frontier and Telecom, and then concludes, broadly in alignment with those submissions, that:

> "section 18 may provide guidance at a number of decision points during the TSLRIC modelling exercise including:
> 65.1 our choices on model design and approach;
> 65.2 the determination or selection of individual parameters in the cost modelling exercise; and
> 65.3 selecting the price within any relevant range provided by the modelling".

158. The Commission has failed to address the frequently given submissions opposing that approach (save as to 65.3 insofar as, and if, that addresses a plausible range; that is not clear in the paper). Thus it has quoted and applied three submissions but ignored others to the contrary.

159. As noted in the introduction to this section, it would be hard for the Commission to miss the multiple times that clients have submitted against such conclusions, in multiple settings, and then fail to deal with those submissions. That background is relevant to the legal position in further indicating breaches. (It also raises the additional concerns that these problems may be happening due to undue haste on the FPP).

160. In this FPP process, the times these s 18 points have been raised, and thus required dealing with by the Commission, include but are not limited to:

a. [54]- [57] InternetNZ, TUANZ, and Consumer cross submissions on UCLL FPP Issues and Processes Paper;

b. High Court submissions by those parties, referenced in that cross submission and also filed with the Commission with that cross submission (they are on the Commission's website);

c. 11 April submission by CallPlus and Orcon at [9]

161. The FPP framework paper makes no reference to those submissions, even when countervailing submissions are referred to.

Some detail

162. In addition, in the context of the more detailed approach required by earlier Commission decisions and judgments, the relationship between s 18 and TSLRIC will need to be revisited. A comprehensive efficiency analysis will require that. For example:

a. The fact that Chorus actually needs no incentives to invest as it has already made the decisions to invest in UFB is relevant.

b. TSLRIC is treated in the FPP framework paper as inherently efficient when, as has been submitted, but not responded to, it is well recognised by regulators as inefficient and inappropriate for sunset networks. TSLRIC has been replaced by other models generally such as RAB. The Commission has not dealt with the point made that, although price setting is constrained to TSLRIC, application of s 18 is not so constrained. But that consideration may become irrelevant when proper cost benefit analyses are undertaken.

163. This problem lies behind the approach in [112] to [117] of the FPP framework paper. For example, the Commission incorrectly states that "A common theme internationally and in our previous approach to TSLRIC is the ability of a TSLRIC price to incentivise build or buy choices.".

164. In the real world of regulatory specialists, few would agree with that proposition in relation to sunset networks. (Plus, the Commission's "previous approach" was around 10 years ago when the network was not end of life, so that is irrelevant). TSLRIC does not as to end of life networks reflect efficiency including as to build buy choices. That is why so many regulators and legislators have got rid of TSLRIC. For the TSLRIC calculation, the Commission is stuck with TSLRIC. It is not constrained by that as to s 18 nor is it required to –incorrectly- state that TSLRIC produces optimal efficiencies. If such a view converted into impacts on price, Chorus would over-recover as TSLRIC over-recovers.

165. But in the end, this detail may not matter, as a properly undertaken quantitative CBA will not be limited by the weaknesses of TSLRIC.

Commission flexibility under s 18?

166. As the Commission needs to go back to consultation after reformulating its approach we don't go into detail on the s 18 approach. However, it may help the Commission to clarify as to three issues. First as to flexibility. [60] and [61] of the FPP framework paper, in isolation, give the impression that the Commission has relatively wide discretion as to how it applies s 18.

167. In context however, and also having regard to submissions not addressed, that is not so. The fundamental point is that the structure of the Act requires the price to be derived on the basis of cost evidence and analysis. Cost is cost. TSLRIC is a cost price. Full stop. To that extent the Commission has no flexibility. But the Commission does have flexibility when it has a decision that cannot be resolved solely on cost

considerations. Then it has relatively wide discretion as to how it applies s 18. The context of the High Court's observations noted at [60] and [61] is an example of this (and indeed the observations must be read in that context). The context is that the Court said that the Commission had the freedom under s 18 to apply it only once in the process; it could have done that differently.

"TSLRIC objectives" and s 18

168. At [109] to [127], in unclearly stated manner, the Commission wrongly conflates what it calls "TSLRIC objectives" with what are s 18 issues such as investment efficiency and predictability. As noted in the next section, that focus, away from s 18, is incorrect. Here, however, we address a more fundamental problem: the incorrect assessment of what the TSLRIC objectives are. This highlights again the importance of rigour and a careful analytical approach in the modelling.

169. First, if we are to use "TSLRIC objectives" as an approach, it needs to be right. "TSLRIC objectives" are used in the FPP framework paper in the sense of providing guidance as to how the modelling is done, rather than in the sense of ultimate outcomes from TSLRIC. As outlined extensively in earlier but ignored submissions, the TSLRIC objectives, seen that way, have nothing to do with outcomes such as investment efficiency and predictability and cost, except that such outcomes may flow from TSLRIC (the flow is not in the opposite direction).

170. TSLRIC is solely about cost. That is what the Act states. Cost is cost. The starting point is that the TSLRIC objectives are to derive the cost based price. Applying s 18 can and often will move the price away from cost and that is wrong. That is why the plausible range concept coined by the Commission is so valuable. That is the time when s 18 applies, including factors such as investment efficiency and predictability (if and to the extent they are s 18 factors).

171. More to the immediate point, the paper has ignored submissions and re-consultation on an updated draft is needed.

"Prudent investors" and predictability

172. The interests of prudent investors, and related concepts of predictability have been introduced in the FPP framework paper, without reasons given. Those matters **might** have a role to play in the efficiency analysis under s 18 including s 18(2A). Predictability and incentives to invest after all are factors in dynamic efficiencies. But singling out the prudent investor to this degree fails to undertake and effect a more cohesive efficiencies analysis, and is an incorrect application of s 18. Like s 18, these prudent investor and predictability concepts crop up in multiple places in the FPP framework paper. When the position is remedied as to the initial point – prudent investor and predictability – there are multiple consequent matters to be revisited, reformulated and consulted upon.

173. But in any event there are problems with this approach:

a. The Commission has not addressed the submissions on s 18 as they affect this point;

b. It has not yet given reasons;
c. The approach unravels when the requiring detailed evidential and quantitative CBA is undertaken: that has no room for such an overlay on the required efficiency analysis.

TSLRIC FPP determination process is still too truncated

174. We acknowledge the Commission has made improvements to its TSLRIC FPP determination process, with the extension of the target for a determination from December to April, and the inclusion of additional consultation steps. We remain of the view that the original November 2015 timeframe would be more prudent.

175. All submitters, including Chorus, supported additional consultation steps on the model etc ahead of the draft determination.

176. Internet NZ also noted that "All submissions bar Chorus' are consistent with our view that the determination process is being unnecessarily rushed that there needs to be a greater level of understanding of the Commission's process and intentions; there needs to be substantial resolution between parties (where possible and reasonable) across a range of issues before real progress can be made; and, that it is only a matter of time before a legal challenge is made or a judicial review is sought".[54]

177. Submitters consistently expressed concern that a rushed process would risk poor decisions that conflate the TSLRIC prices.

178. We note the comments from Vodafone that they did "…not accept Chorus' argument that considerations such as the need to avoid confronting additional and unique issues or risking the completion of FPP process by 1 December 2014 have any place in the Commission's approach to MEA selection. Indeed we consider that arbitrarily constraining the Commission's scope of enquiry in order to avoid confronting issues that ought to be addressed or to meet a discretionary administrative target would serve to weaken the ultimate decision reached."[55]

179. Our submissions went into detail about the potential consequences of a consultation process that is too truncated; for example, that interested parties would not have adequate time to engage or respond to the Commission's consultation; the "omnibus" consultation the Commission had proposed would not allow for proper consideration of submission's in the Commission's policy development and methodology implementation, the Commission would be forced to be overly reliant on Chorus' and Chorus' data[56], and the result will inevitably be inflated TSLRIC price determinations

[54] InternetNZ, InternetNZ Cross Submission: Further Consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the Final Pricing Principle, 30 April 2014, page 3.
[55] Vodafone, Cross-submission on further consultation papers on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle, 30 April 2014, paragraph B2.4.
[56] The pre-Telecom split Chorus modelling of TSO net costs and PSTN TSLRIC show the inherent risk with this. Refer to: The Commission should not rely on Chorus' TSLRIC modelling.

which would detrimentally impact on competition and the long-term interests of end-users.[57]

180. Consistent with this we agree with Network Strategies that "A common theme throughout Chorus' submission is an emphasis on avoiding complexity and saving resources – both cost and time. To that end, Chorus offers a number of suggestions that frequently run counter to the requirements of the final pricing principle. Such suggestions must be ignored – the Commission does not have the luxury of being able to diverge from the final pricing principle purely for reasons of convenience".[58]

181. We are raising these points again, albeit treating the detail behind our arguments as read, as the extension of the Commission's process only partially mitigates our concerns. The process is still too truncated. The Commission's original November 2015 process timeline is much more realistic than April 2015.

182. Based on the material the Commission has released, to date, a major concern we have is that the Commission will not be able to fully have regard to the views of submitters, or undertake and produce the type of analysis and evidence that is legally required when the Commission exercises its discretion and judgement.[59]

There are still missing steps in the Commission's consultation

183. As noted above, the material the Commission has released is very high level in terms of how the TSLRIC modelling will be undertaken.

184. We have no idea, for example, what assumptions the Commission will adopt about terrain/soil type. Assumptions about soft/medium/hard soil conditions are a major part of the cost of underground network build but the Commission has not released anything on this yet. We have no idea how far, if at all, the Commission has progressed such matters.

185. It would not be safe to go from the current high level consultation to consultation on the draft determination. The previous planned process would have meant an omnibus draft determination consultation. The revised process still leaves us with an 'omnibus-iti' consultation at the draft determination stage.

186. There are still a number of critical steps missing in the process, including:[60]

a. Consultation on detailing model specification/modelling instructions which needs to occur prior to TERA commencing the modelling work. This needs to included detailed/prescriptive assumptions that the Commission proposes to use;

b. Consultation on proposed inputs and assumptions e.g. forecasts of inflation, demand growth, opex, and capex, replacement costs and asset lives, the cost of

[57] Notably, no parties including Chorus' disputed the concerns raised by CallPlus and others; despite ample opportunity to do so through the submission and cross-submission process.
[58] Network Strategies, Cross-submission on UCLL and UBA TSLRIC further consultation paper, 30 April 2014, page 22.
[59] Refer to the next section: Commission decisions must be evidence based.
[60] Refer also: CallPlus and Orcon joint submission, Submissions by CallPlus and Orcon following the further consultation paper and workshops, 11 April 2014, paragraph 16.63.

alternative technologies such as wireless, the WACC percentile the Commission proposes to adopt,;

c. Release for consultation of the model the Commission proposes to use

187. Our assessment is based on where the Commission is at now, and what needs to be done and what should be done, is that the original November 2015 consultation timeframe would be challenging. The Commission simply has not made enough progress to be targeting December/April, dates that were always overly ambitious anyway.

Concerns about the judgments the Commission is making about the "benefits" of higher TSLRIC prices

188. It appears that the Commission intends to make a number of decisions which could result in overstatement of the TSLRIC price, such as partial optimisation, not fully assessing the cost of different potential MEAs, not taking into account third party service provision and valuing re-usable assets at ORC.

189. We are particularly uneasy about the Commission's…

> "intention to respect reasonable investor expectations to avoid the risk of chilling investment, when combined with the associated positive externalities and migration efficiencies from the generally higher prices that may result (from our decisions on the performance adjustment, and reuse of Chorus' assets), will best give effect to the section 18 purpose – without directly raising prices further. … For example, this concern for investment will influence our choices on the re-use of Chorus' assets and the rejection of a capability-based performance adjustment for the UCLL MEA. …. This concern may also affect our consideration of adjustments, if any, to the modelled price either upwards or downwards".[61]

190. We have dealt with legal considerations on this earlier in this submission. Leaving aside the contradictory statement that the Commission's proposals may result in "generally higher prices … without directly raising prices further", we object to any suggestion the Commission should err on the side of "generally higher prices" or that "the risk of chilling investment", "positive externalities" or "migrations efficiencies" provide a sound basis for erring on the side of "generally higher prices".

191. The Commission appears to be making the same mistakes, identified by the High Court, that it made with its decision to set the WACC percentile for regulated suppliers under Part 4 of the Commerce Act at 75th e.g. relying on assumptions about the appropriate approach to take, and not undertaking empirical analysis to verify the merit of the decision.

192. We refer the Commission to our submissions on calculation of WACC and why the Commission should err on the lower side of WACC percentile options. These arguments are equally applicable to any judgements that could result in a higher or lower TSLRIC price. In summary, incentives to invest in copper have limited relevance. It is old technology which is being replaced by fibre. Concern about incentives to invest in copper are analogous to being concerned about whether electronic goods manufacturers would continue to invest in manufacture of tube TVs and VCRs.

---

[61] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraphs 125 - 127.

193. We refer the Commission also to the submissions in response to MBIE's Telecommunications Act review consultation. The overwhelming message from submissions was that unnecessarily high copper prices could undermine take up of broadband and incentivise Chorus' to roll-out fibre services no quicker than it is contractually obliged to do.

194. Ingo Vogelsang also provides useful material for making judgments about whether the Commission should err on the high or low side (high) of a price determination, the impact the UFB initiative should have on the Commission's price determination (none), and what WACC percentile to select (lower than for energy).

195. We agree with Vogelsang that:

a. "spillover benefits of fibre, if any, are addressed by UFB subsidy".[62]

b. "Under the wholesale revenue effect an increase in the wholesale price of the old technology reduces the incentives to invest in the new technology because such investment cannibalizes wholesale profits. Because of this effect an increased wholesale charge for the old technology will make the old technology more attractive to Chorus than the new technology."[63]

c. "In addition, the LFCs face Chorus as a formidable copper competitor who may undercut the regulated wholesale UBA price cap, because on account of sunkness Chorus' forward-looking costs will be much below the TSLRIC. Chorus could here follow a limit-pricing strategy, trading off an accelerated (inevitable) loss in market share against higher markups on UBA cost. Thus, the question is if the envisaged increase in the wholesale price of the UCLL portion of the UBA aggregate is still below Chorus' profit-maximizing price taking into consideration its effect on the future price and quantity path."[64]

[62] Ingo Vogelsang, The effects of the UCLL contribution to the UBA aggregate on competition for the long-term benefit of end-users in New Zealand telecommunications markets, 2 July 2014.
[63] Ingo Vogelsang, The effects of the UCLL contribution to the UBA aggregate on competition for the long-term benefit of end-users in New Zealand telecommunications markets, 2 July 2014.
[64] Ingo Vogelsang, The effects of the UCLL contribution to the UBA aggregate on competition for the long-term benefit of end-users in New Zealand telecommunications markets, 2 July 2014.

The Commission should not rely on Chorus' TSLRIC modelling

196. We support the Commission placing a time-limit on when alternative TSLRIC models can be submitted by parties. If they are provided at the 11th hour there would be the prospect that the Commission's time-line would be put under further pressure. The Commission and interested parties need adequate time to review any alternative TSLRIC models that might be proposed. We also support the Commission's stance that it will not consider TSLRIC models submitted after 1 December.

197. At least for Chorus' we question why the 1 December is the deadline for any alternative TSLRIC models, and why an earlier date was not issued. We would prefer that any alternative TSLRIC models are reviewed and consulted on prior to the Commission issuing its draft determination. We would be very concerned if we needed to review the Commission's draft determination, and other parties' TSLRIC models concurrently; particularly given the short period of time the Commission intends to provide for consultation.

198. We understand that Chorus' has already undertaken TSLRIC modelling for UCLL and UBA services, including variations to the modelling to identify the key drivers for the cost determination, and the range of potential outcomes that could come out of the TSLRIC determination process. It should be in a position to provide the Commission with its modelling now.

199. We are not aware whether Chorus' intends to provide the Commission with any version of its TSLRIC modelling, but we would caution against any reliance on it.

200. The pre-Telecom split Chorus provided its cost modelling for the TSO cost determinations and the (uncompleted) PSTN TSLRIC determination. The results were grossly inflated calculations of Chorus' costs. Chorus' calculation of the net cost of the TSO was grossly inflated compared even to its own previous calculation (under the Telecommunications Information Disclosure Regulations 1999) let alone compared to the Commission's ultimate cost determinations.

201. This is borne out by the observations TelstraClear has made in relation to Chorus' past disclosures of its modelling results:

> [Chorus'] incentives to overstate TSLRIC have been borne out by by their estimate of TSLRIC which is nearly double that of the Commission's. Because of [Chorus'] incentives to inflate TSLRIC the Commission should reject [Chorus'] calculation of the TSLRIC price.[65]
>
> … during the Commission's benchmarking exercise to determine the interconnection rate under the initial pricing principle, [Chorus] argued that the Commission should maintain the interconnection rate at 2.7cpm. In response to the Commission's section 45 notice of April 2004, [Chorus] calculated TSLRIC to be 1.86cpm. Yet [Chorus] subsequently stated that the Commission's rate of 1cpm *"is within an acceptable band"*.[66]

[65] TelstraClear, Submission on the Draft Determination on the Application for Pricing Review for Designated Interconnection Services, 26 May 2005, paragraph 3.
[66] TelstraClear, Submission on the Draft Determination on the Application for Pricing Review for Designated Interconnection Services, 26 May 2005, paragraph 38.

> This is also borne out by the experience with [Chorus'] calculation of the net cost of the TSO. Under the Telecommunications Information Disclosure Regulations 1999, [Chorus] was required to disclose its net cost of the Kiwi Share Obligation (KSO), as the TSO was then known. For the financial year to 30 June 2000, [Chorus] estimated the net cost to be $167m. For the financial year to 30 June 2001, [Chorus] estimated the net cost to be $174m. Under the Telecommunications Act, [Chorus] subsequently estimated(on an annualised basis) that the net cost of the TSO to 30 June 2002 was $425m (which [Chorus] subsequently reduced to $408m after making minor changes to the methodology requested by the Commission). [Chorus] has moderated its estimate slightly since then, and has claimed that for the financial year to 30 June 2003 the net cost of the TSO was $344m.[67]

202. The Chorus TSO net cost modelling of between $167m (2000/2001) and $408m[68] (2001/02) contrasts with the Commission's determinations, for example, of $65.57m (2001/02) and $56.75m (2002/03), in the first two years the Commission calculated the cost, and $69.72m (2008/09, draft) in the final year the Commission calculated the cost.[69]

203. In a similar vein, we note the following comment from InternetNZ: "Chorus' incentives are to seek the highest possible cost figures both for its current network and for any alternative MEA. Any data provided by Chorus should be thoroughly audited and the basis upon which core assets are valued made transparent".[70]

The Commission needs to be clear about what it means by "reasonable investor expectations" and how it is relevant to the Telecommunications Act and TSLRIC

204. The consultation paper makes repeated reference to "reasonable investor expectations" in relation to a number of judgments it makes about how to determine TSLRIC prices.

205. The Commission does not define what it means by "reasonable investor expectations".

206. We note that the High Court made reference to "reasonable investor expectations" in its 2013 Part 4 IM Merit Appeal decision. The High Court made the following statement:[71]

> In our view, reasonable investor expectations should be met by the Commission following a carefully considered approach … subject to there being no evidence that suppliers would be unable to recover the costs of their past prudent and efficient investments.

---

[67] TelstraClear, Submission on the Draft Determination on the Application for Pricing Review for Designated Interconnection Services, 26 May 2005, footnote 6.

[68] We understand that internal versions of the modelling that were not released produced even higher cost results.

[69] The Commission eventually succeeded in getting pre-split Chorus to produce more realistic TSO net cost calculations by providing highly prescriptive instructions as to how the cost should be calculated, including requiring Chorus to use the Commissions' TSO calculation models.

[70] InternetNZ, InternetNZ Cross Submission: Further Consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the Final Pricing Principle, 30 April 2014, page 7.

[71] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraphs [605] and [759].

207. In this context we note that no evidence has been provided by either Chorus or the Commission that the Commission's price determinations (IPP or FPP), or any options for how to apply TSLRIC, could result in a situation where Chorus "would be unable to recover the costs of their past prudent and efficient investments".

208. If the Commission's pricing determinations set prices so low that Chorus "would be unable to recover the costs of their past prudent and efficient investments" it is safe to assume that it would invoke clause 7 of the TSO Deed and seek relief from the unreasonable impairment of the profitability of its fixed line business. The fact Chorus has not done this confirms the Commission's pricing decisions have caused no such issue. (This is consistent with Vector's assessment that the IPP would still enable Chorus' to earn a ROI north of 20%.) The High Court Part 4 Merit Appeal decision makes clear that such an inference is appropriate:

> … no regulated supplier – other than Vector whose evidence we did not find persuasive – provided factual evidence to suggest that the initial RAB values were such that over the lifetime of the assets the suppliers would in fact earn less than normal returns … like the Commission we think that is of considerable significance.[72]
>
> The Commission had … the reasonable understanding that the 2009 regulatory valuations were sufficiently high for regulated suppliers to earn at least a normal return on capital for past investments. That understanding had been confirmed by the lack of evidence from suppliers that that would not be the case.[73]

209. We also note there are a number legislative differences between Part 2 of the Telecommunications Act and Part 4 of the Commerce Act that are relevant to "reasonable investor expectations", for example:

a. The calculation of TSLRIC under Part 2 of the Telecommunications Act is based on that of a hypothetical efficient operator, while price control under Part 4 of the Commerce Act is based on that of the access supplier or regulated supplier.

b. TSLRIC is also forward-looking rather than having a backward-looking focus on "past prudent and efficient investments".

c. The Commerce Act purpose (section 52A(1)(a)) includes promoting incentives to invest of the regulated supplier, while the purpose in section 18 of the Telecommunications Act does not distinguish between investment by access providers, access seekers or alternative network providers. The purpose, instead, generically refers to "the incentives to innovate that exist for, and the risks faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services".[74]

210. The distinction between Part 2 of the Telecommunications Act and Part 4 of the Commerce Act is highlighted by TERA's observation that "Chorus justifies its choice of decreasing demand option because of the need to guarantee cost recovery but under a

---

[72] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [589].

[73] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [638].

[74] Notably, this contrasts to the section 52A(1)(a) purpose of Part 4 of the Commerce Act which refers specifically to access providers "incentives to invest", with no reference to access seekers.

TSLRIC forward looking methodology, these are not the incumbent's actual costs that are calculated but the costs of a new network".[75]

211. It is somewhat surprising, therefore, that the current TSLRIC consultation paper makes multiple references to "reasonable investor expectations" whereas the Commission has made no reference to the concept, as far as we are aware, in its Part 4 Commerce Act IPP, DPP and WACC IM consultation processes since the December 2013 High Court Merit Appeal decision. We consider the concept has more relevance to Part 4 of the Commerce Act than Part 2 of the Telecommunications Act.

The Commission appears to be applying a Chorus-centric approach to "reasonable investor expectations" that reflects expectations Chorus' investors could not reasonably have

212. The Commission appears to be applying the concept of "reasonable investor expectations" in Chorus-centric terms. We could not find any reference in the Commission's material to the "reasonable investor expectations" of access seekers or alternative network providers. For example, what are the "reasonable investor expectations" of access seekers such as CallPlus in terms of UCLL and UBA price relativity? Why hasn't the Commission considered this in its consultation paper?

213. We remind the Commission that the purpose in section 18 of the Telecommunications Act does not distinguish between investment by access providers, access seekers or alternative network providers. The purpose, instead, generically refers to "the incentives to innovate that exist for, and the risks faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services".[76]

214. We consider that the Commission is applying the "reasonable investor expectations" concept very liberally in favour of Chorus, including to circumstances where it would be more accurate to describe the investor expectation as "poorly-informed investor expectations".

215. For example, the Commission asserts that "… there would have been a reasonable expectation that assets would be valued at ORC under a TSLRIC model. This suggests that having special rules for valuing re-used assets may not best meet the requirements of section 18".[77]

216. The Commission does not explain why "reasonable investor expectation" would be that assets that could be re-used would be valued at ORC given that "… there is an international trend to include asset re-use in cost models. For example, in the European Commission's guidelines on costing methodologies, the recommendation is to value re-usable civil engineering assets at current cost, based on an indexation method".[78]

---

[75] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 57.
[76] Notably, this contrasts to the section 52A(1)(a) purpose of Part 4 of the Commerce Act which refers specifically to access providers "incentives to invest", with no reference to access seekers.
[77] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 147.
[78] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 145.

217. In our view, the forward-looking costs of a hypothetical efficient operator are the lower of ORC or "costs that are actually likely to be incurred going forward and not limited to replacement cost".[79] This could include the current cost of re-used assets and payments to third parties (which don't necessarily set price on an ORC basis) for facilities such as ducts and poles.

218. Likewise, the Commission's ODV methodology for EDBs (which is reflected in legacy RABs for EDBs), despite being a forward-looking optimised valuation methodology, did not apply ORC for all assets e.g. easements are assets that are re-usable and were not valued at ORC. They were valued at either historic cost or nil value. This was more generous than the previous Ministry of Economic Development ODV Handbook that valued easements at nil value:[80]

> The Commission considers that easement rights should be assigned either: (i) a nil value, reflecting situations where compensatory payments were not made for loss of land use or consequential loss; or (ii) the historic cost value of the rights as recorded in the asset register of the lines business, irrespective of whether these rights were obtained before or after 1993 (or 1988 for Transpower). This differs from the treatment in MED's ODV Handbook (and the Revised Draft ODV Handbook) where all pre-1993 (1988) easements were required to be assigned a nil value.

219. This is particularly relevant given that the 2004 ODV Handbook was subsequently used to value assets up to 2004, under Part 4 of the Commerce Act, as part of the IMs which were applied for the 2010-2015 DPP price control, and will be applied for the 2015 reset. It is also notable that the use of the ODV Handbook was part of the unsuccessful Part 4 IM appeal.

220. The debate over the treatment of these re-usable assets mirrored for TSLRIC with arguments by some, but not all, regulated suppliers that they should be valued at Replacement Cost:[81]

> Similarly, Orion, Powerco, Unison and ENA (explicitly supported by Vector) submitted that the most appropriate basis for the valuation of easements is replacement cost, but indicated that whether the easement was purchased or not is irrelevant. Powerco suggested that the replacement cost can be estimated by applying the underlying allocation rights to the current market value of the land affected by the easement. Powerco acknowledged that it might be argued that such an approach could provide lines businesses with a "windfall" gain if the replacement cost of the easement were much higher than the acquisition cost. However, Powerco claimed that valuing easements at replacement cost reflects today's cost of providing the service, which is essential if future investment is to be dynamically efficient. Further, Geoffrey Horton (on behalf of Powerco) noted that the calculation of the appropriate return is different for assets valued at historic cost than that for assets valued at ODV.
>
> In contrast … in its submission on the Issues Paper, PwC (on behalf of 19 distribution businesses) stated that the value of easements should reflect the historical amounts paid for registering and acquiring the rights, because most existing assets have access rights granted in perpetuity for the life of the asset. PwC added that this principle is also appropriate for new easements acquired.

---

[79] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 133.

[80] Commerce Commission, Regulation of Electricity Lines Businesses A Companion Report to the Handbook for Optimised Deprival Valuation of System Fixed Assets of Electricity Lines Businesses, 31 August 2004, paragraph 168.

[81] Commerce Commission, Regulation of Electricity Lines Businesses A Companion Report to the Handbook for Optimised Deprival Valuation of System Fixed Assets of Electricity Lines Businesses, 31 August 2004, paragraphs 154 - 155.

221. In rejecting Replacement Cost the Commission noted "… dynamic efficiency will not be harmed by valuing easements at historic cost, given that easements are not replaced".[82]

222. This historic debate over treatment of easements/re-usable assets was repeated as part of the Asset Valuation IMs development process and the Commission reached the same conclusions. We cite the following text to recap the debate at the time:[83]

> Under the Commission's draft decision for the initial RAB, the value of existing easements will be the value for those easements included in each EDB's 2009 disclosures. Thus existing easements will be valued at historic cost.
>
> Submitters on this issue had mixed views on the appropriate valuation of existing easements. Unison and GasNet agreed with the Commission's preliminary view that easements should be valued at historic cost. Dissenting parties supported either a new market value or replacement cost approach on the basis that this would be consistent with the treatment of other system fixed assets, and is necessary to ensure that businesses are able to earn a fair return.
>
> The Commission considers that different treatment for establishing the value of easements in the initial RAB from that adopted for other network assets or land is appropriate given the very different characteristics of easement rights. Easement rights are sunk assets … Easements are distinct from other sunk assets (such as network assets) because easement rights usually do not suffer physical deterioration or obsolescence, and are usually available to the supplier in perpetuity (i.e. do not need to be replaced). In light of these characteristics, the Commission considers opportunity cost or replacement cost valuations are inappropriate for existing easements. (Emphasis added)

223. The Commission also, weakly, states that valuing re-usable costs at current costs "… would represent a change in our previous approach to asset valuation under a TSLRIC methodology".[84] We note the previous application of TSLRIC only reached the draft determination stage.

224. We are of the view that any well-informed investor, who is aware of how TSLRIC is applied internationally, and is aware of asset valuation precedent under the Commerce Act, would not presume that re-usable assets would be valued at ORC. We understand that Chorus' TSLRIC modelling applies both historic cost and ORC.

A reasonable investor that understands the Telecommunications Act would expect the UCLL and UBA FPP prices to head south compared to the IPP prices

225. It was clearly anticipated by all parties, and reflects "reasonable investor expectations", that UCLL and UBA prices would substantially reduce.

226. This was recognised in both Chorus' launch prospectus, as part of its separation from Telecom, and the Government decision to grant Chorus a three year holiday from the Commission resetting its prices.[85]

---

[82] Commerce Commission, Regulation of Electricity Lines Businesses A Companion Report to the Handbook for Optimised Deprival Valuation of System Fixed Assets of Electricity Lines Businesses, 31 August 2004, paragraph 162.

[83] Commerce Commission, Draft Reasons Paper, Input Methodologies (Electricity Distribution Services), June 2010, paragraphs 4.4.128 – 4.4.130.

[84] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 145.

[85] http://www.parliament.nz/resource/0000171267

227. This was emphasised recently by the Chair of the Commission, Mark Berry, who noted "It was a bit surprising that analysts and others in the industry didn't see that [the IPP price reduction] coming" and that "[the ruling by] Justice Kos did say there was always going to be a pricing sea change".[86]

228. The point that Chorus knew that prices would decrease substantially was also widely canvassed in submissions made to MBIE in response to its Telecommunications Act review consultation. Vector, for example, notes that "Chorus must have been well aware of the likelihood that the revision of copper access prices would result in significantly lower copper revenue. We presume Chorus would have undertaken its own forecasting of likely benchmark and TSLRIC based price setting".[87]

229. Vector's submissions, which have not been disputed by Chorus despite ample opportunity to do so through several submission and cross-submission processes, have forecast that existing IPP copper prices would provide Chorus excessive returns of 19 – 23% between 2015 and 2020, based on the Commission's Part 4 modelling.[88]

230. This strongly suggests the FPP copper prices (in aggregate[89]) should be substantially reduced, relative to the IPP prices, in order to ensure they are cost-based and provide Chorus with no more than a normal rate of return on the TSLRIC value of its sunk copper assets, unless there is clear information "on whether there is any reason to believe that New Zealand is fundamentally different to other countries that have set cost-based prices for UCLL and UBA in a way that might results in costs that fall outside the known European cost-based range".[90]

231. This is reinforced further by Telecom's benchmarking of UCLL and UBA prices in western European countries that have applied cost-based or cost-orientated prices for both services. Telecom's updated analysis shows that the Commission's aggregate UCLL and UBA price is above ALL European prices, although the UBA price is at the bottom end of the range (relevant for relativity considerations).[91]

We are concerned the Commission appears to be making draft decisions without adequate basis or evidence

232. This section only deals with facets of this evidence issue. The bigger point is dealt with above: there must be robust evidence and analysis of that evidence in all areas.

233. While we appreciate the Commission is expressing "preliminary views", at this stage, "on a number of fundamental assumptions for the development of a TSLRIC cost model

---

[86] Sunday Star Times, Getting a fair deal for consumers, 27 July 2014.
[87] Vector, Submission to the Ministry of Business, Innovation & Employment on Review of the Telecommunications Act, 13 September 2013, paragraph 71.
[88] Refer: Vector, Submission to the Ministry of Business, Innovation & Employment on Review of the Telecommunications Act, 13 September 2013, paragraph 22. Refer also: Vector, Submission to the Commerce Commission on the Scoping and Issues Discussion Paper for UCLL TSLRIC, 14 February 2014, paragraphs 23 – 29.
[89] Vector did not calculate returns based on individual UCLL or UBA services.
[90] Telecom, cross-submission, UCLL and UBA FPP: further consultation and supplementary paper, 30 April 2014, page 1.
[91] Telecom, cross-submission, UCLL and UBA FPP: further consultation and supplementary paper, 30 April 2014, page 1.

for the UCLL and UBA services"[92] we are mindful that the Commission has given itself only a very limited time between this consultation and issue of a draft determination. We are concerned this will not be sufficient for the Commission to fully test its preliminary views/assumptions to ensure its draft determination is sufficiently evidence-based. For example:

a. We agree "It is difficult to predict whether in New Zealand the modelled FTTH network will appear more or less expensive than the modelled copper/FTTN network. This depends on national circumstances." This needs to be empirically tested and modelled. It would not be sufficient to rely on "preliminary analysis" based on "several data sources".[93]

b. We agree "it is difficult to predict whether the cost of a FTTH or FWA network will be cheaper than copper".[94] The Commission needs to test whether FTTH with FWA for remote areas would the least cost/most efficient option for a hypothetical efficient operator. The same comment applies to the Commission's assumption that it should model UBA on a copper-network basis.

c. The Commission needs to test where the boundary would be between FTTH and FWA being the least cost options (if they are the least cost options). It is not sufficient to assume that a hypothetical efficient operator would have the same fixed/wireless boundary as the Government's RBI scheme.[95] The work conducted by Network Strategies in relation to wireless technology (and the subsequent Court commentary) provides a useful illustration of the type of analysis the Commission is required to conduct.

d. The Commission states that "If the copper cost appears to be higher than FTTH/FWA cost, adjustments are not necessary and the UCLL price is set based on the FTTH/FWA cost" (emphasis added).[96] The Commission needs to test whether or not copper would be more expensive than FTTH/FWA.

e. The Commission states that "Our view, consistent with other submitters, is that Parliament intended us to undertake a more conventional TSLRIC exercise, by building a TSLRIC cost model to determine the costs incurred by a hypothetical operator using the most efficient means at any point in time to provide the service." (Emphasis added).[97] We fully support the Commission's position; particularly the unqualified view that the appropriate efficiency standard is "the most efficient means".

   Contrary to the above statement, though, the Commission is making a number of assumptions about the extent to which the TSLRIC modelling should reflect that of a

[92] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 12.2.
[93] TERA, TSLRIC price review determination for the Unbundled Copper Local Loop and Unbundled Bitstream Access services: Modern Equivalent Assets and relevant scenarios, July 2014, page 25.
[94] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 162.2.
[95] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 164.
[96] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 180.
[97] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 103.

hypothetical efficient operator vis-à-vis a "Relatively Efficient Operator" (relative to what?) vis-à-vis Chorus' actual network and costs. To the extent the Commission has discretion over the level of efficiency that is applied under TSLRIC (how efficient is efficient?) it needs to be able to demonstrate this meets the requirements of section 18 of the Telecommunications Act.

f. What is the basis for the Commission's assumption that increasing copper prices "may lead to greater migration to the UFB" (emphasis added)?[98]

   There have been a large number of submissions, particularly in response to MBIE's consultation paper proposing to over-ride the Commission's UCLL and UBA price determination decisions, that if copper prices are kept artificially high this will disincentivise Chorus' from promoting migration/rolling out fibre any quicker than it is obliged to, and could result in slower fibre migration. The Commission needs to test the validity of its assumptions before making decisions based on them.

g. Likewise, what is the basis of claims that "generally higher prices" would "avoid the risk of chilling investment"?[99] The Commission is just making an assumption without backing it up with evidence.

   We again refer the Commission, in particular, to submissions in response to MBIE's Telecommunications Act review which strongly refute the suggestion that artificially high copper prices would result in greater investment in fibre.

   These are critical questions given the Commission is relying on assumed "positive externalities and migration efficiencies" to justify "generally higher prices".[100]

The Commission needs to take relativity into account in terms of how to apply TSLRIC

234. We agree with the Commission's preliminary view that "Relativity is a mandatory consideration in its own right under the Act".[101]

235. Relativity is a special case under the Act. Under s 19, s 18 is a mandatory consideration for all decisions under Part 2 of the Act, ranging from Schedule 3 investigations to IPPs and FPPs. That mandatory application however has a limited role.

236. Importantly, on top of that mandatory obligation, the Act adds an overlapping mandatory obligation to consider relativity when doing an UBA IPP and FPP. Meaning has to be given to what is a mandatory direction on top of another mandatory direction. This implies that the relativity obligation must intervene as to the UBA price where that

[98] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 81.
[99] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 86.
[100] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 86.
[101] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 74.

would not happen as to other judgment calls in relation to the FPP and other decisions under Part 2. Relativity can be lawfully changed as between UBA and UCLL for reasons other than cost so long as that achieves efficient relativity.

237. One reason that relativity is a special case is the issue of margin squeeze. That has Commerce Act implications: if the UBA uplift price is set too low, there will be Commerce Act margin squeeze by Chorus: the Telstra Clear data tails Court of Appeal decision makes it clear that the fact that the price points ((a) UBA + UCLL and (b) UBA) are regulated does not remove Commerce Act rights under s 63 of the Telecommunications Act.

238. But margin squeeze also has regulatory implications including as to ladder of investment and the inefficient effects of margin squeeze.

239. The significance of the mandatory relativity requirement is as follows:

a. If a fibre MEA is used for UBA, the starting cost of the equivalent of the UBA uplift would be very small (say, less than a dollar based on the TERA views in their Danish reports given the lit fibre component is such a small part of all up fibre cost). Such relativity would produce inefficient outcomes for end users, given the low gap between UCLL and UCLL + UBA. To produce efficient outcomes, consistent with s 18, and applying the relativity direction in the service description, the Commission can lawfully increase the UBA uplift price. The benefit of applying this approach is that the Commission can:

    i. Apply a consistent MEA for both UCLL and UBA; and
    ii. Lawfully increase the UBA uplift price to achieve efficiencies in terms of relativities.

    That overcomes problems with using a fibre MEA for UBA: the Commission, due to the unique relativity requirement, can make substantial adjustments independently of cost considerations.

b. If however a copper MEA is used for UBA, the starting cost would be relatively much higher (say, $10.92 being the IPP). At that high end, to adjust the UBA price upwards to achieve greater relativity would be inefficient. If movement is required, that should be as to the UCLL price, and not the UBA uplift price. This would still leave a relatively much higher UCLL + UBA price however.

240. Ensuring appropriate relativity between UCLL and UBA prices is a key issue if the Commission is to successfully promote competition for the long-term benefit of end-users.

241. Another way of viewing this issue is that the s 18 analysis as to relativity should be focussed quite differently from s 18 analysis as to other issues. For example, as identified below, if, generally, it is considered that there is asymmetric risk from

underestimating cost and price, the approach as to relativity may be different: that there is asymmetric risk from having relativity that is too close.

242. The Commission should satisfy itself that the price relativity is appropriate and does not result in a price squeeze. It would be particularly unfortunate if the Commission set UCLL and UBA prices that resulted in a price squeeze which would fail Commerce Act tests, particularly given the Commission's responsibility for administering and enforcing the Commerce Act

243. Consistent with this, the Commission should consider the option raised, but not favoured, by Telecom of identifying "a "relativity standard" with reference to one or more real-world access seekers."[102] New entrant investment and cost would be the closest real world proxy for a hypothetical new entrant. And certainly much closer than reliance on Chorus' existing network build cost. It may be useful for the Commission to consider the UBA prices that are set on the basis of retail minus (e.g. Portugal and Ireland), or based on a price squeeze test (e.g. Austria and Germany), as identified by Telecom.

Addressing relativity should not result in higher prices to end-users

244. The Commission incorrectly assumes that addressing relativity would result in higher prices for end-users. For example, the Commission states that "a UBA price above the median would be likely to increase the prices faced by end-users"[103] and addressing relativity could "simply result in end-users paying more".[104]

245. Relativity should not be achieved by simply increasing the UBA price (and therefore the aggregate UCLL and UBA price). We recognise that higher aggregate prices could result in higher retail prices that would be a cost to end-users. That is unnecessary to ensure an appropriate relativity (wide margin between UCLL and UBA prices).

246. The best way to ensure the margin between UCLL and UBA prices achieves appropriate relativity is to use the relativity mandatory requirement to err on the low side for the UCLL prices. This can be done such that the retail prices consumers face where aggregated UCLL and UBA is used by the access seeker are unaffected, but consumers would benefit from the lower cost delivery of service from UCLL-only access seekers. Any windfall that Chorus may have obtained from higher than otherwise UBA prices would be offset in full by lower UCLL prices.

247. This of course does not preclude that "Although the Commission must consider relativity, it does not follow that this will have an observable effect on its pricing decision".[105] If the TSLRIC prices for UCLL and UBA result in a sufficient price margin (as

[102] Telecom, UCLL and UBA FPP: further consultation and supplementary paper, 11 April 2014, paragraph 50.
[103] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 75.
[104] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 77.
[105] Russell McVeagh, advice to Telecom, UCLL and UBA Final Pricing Reviews, 30 April 2014, paragraph 4(f).

did the IPP) such that there would be no price squeeze then the relativity clause need not have an observable effect on its pricing decision.

Relativity is an important statutory issue

248. There are asymmetric costs from underestimating or overestimating the relative price of UCLL and UBA:

> When considering relativity CallPlus believes that the risks associated with underestimating the relativity far exceed the risk of overstating …[106]
>
> If the differential between UCLL & UBA is set too low clearly unbundlers are disadvantaged. Unbundling has been encouraged by the regulatory regime … and the benefits in terms of competition and consumers has been well established by the Commission itself in numerous monitoring reports.[107]

249. In relation to this issue, Chorus, and its legal advisers Chapman Tripp, have correctly interpreted the requirements of the Telecommunications Act:

> We disagree with the proposition that applying TSLRIC pricing rules to the UBA and UCLL service can be assumed on its own to maintain the relativity consideration. Or, to put that another way, that the Commission is not required to consider relativity any further as long as its sets TSLRIC prices.
>
> Rather, the Commission must turn its mind to relativity as an additional consideration to what it would otherwise consider when applying TSLRIC …
>
> The Commission must have due regard to relativity and its implications with reference to section 18 and make a decision that best promotes section 18 … we think … the Commission will have to grapple with the ladder of investment and copper to fibre migration implications.[108]
>
> … the Commission is required … to have regard to the relativity (encompassing the concept of a "ladder of investment") between the UCLL and UBA services. It is an error of law to merely set TSLRIC prices on the assumption that this will address relativity issues without express regard to this consideration.[109]
>
> … the Commission is required … to have regard to the relativity (encompassing the "build/buy" concept) …
>
> … The legislative history of the Act indicates that "relativity" should be interpreted with regard to promoting efficient build/buy decisions by network competitors in choosing wither to seek access to the layer 1 and layer 2 services designated in Schedule 1 (the "build/buy" concept) …[110]
>
> If the relativity is not sufficient to allow efficient investment, then the Commission will need to take account of this in its modelling.[111]

---

[106] CallPlus, Submission on the further consultation on Issues Relating to Chorus UCLL and UBA services, April 2014, paragraph 13.
[107] CallPlus, Submission on the further consultation on Issues Relating to Chorus UCLL and UBA services, April 2014, paragraph 50.
[108] Chorus, Submission in response to the Commerce Commission's Further consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle – Consultation Paper (14 March 2014) and Supplementary Paper (25 March 2014), 11 April 2014, paragraphs 151 - 153.
[109] Chapman Tripp, Memorandum to Chorus, Unbundled Cooper Local Loop (UCLL) and Unbundled Bitstream (UBA) access services – pricing review determination (PRDs) – Legal framework, 11 April 2014, paragraph 5.7.
[110] Chapman Tripp, Memorandum to Chorus, Unbundled Cooper Local Loop (UCLL) and Unbundled Bitstream (UBA) access services – pricing review determination (PRDs) – Legal framework, 11 April 2014, paragraphs 26(O) and 27.
[111] Chorus, Submission in response to the Commerce Commission's Further consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle – Consultation Paper (14 March 2014) and Supplementary Paper (25 March 2014), 11 April 2014, paragraph 35.2.

> The legislative intent of the relativity consideration seems to require the Commission to consider whether its pricing decisions are consistent with the "ladder of investment" that the regulated access services were intended to create. That is, whether the prices of UBA and UCLL are such that an access seeker has an incentive to migrate its business from the UBA platform to the UCLL platform. The ability of an access seeker to move up the ladder of investment was seen as promoting the section 18 purpose.[112]

Vodafone and Telecom are downplaying the relativity issue

250. Telecom (and Vodafone[113]) argue that "One valid interpretation of "relativity" is that, when the Commission sets both prices at the TSLRIC cost-based level, the correct relative investment signals and incentives are set in a way that best promotes competition and the competitive outcomes sought by section 18".[114] Russell McVeagh make similar claims arguing that "If the prices for UCLL, SLU and UBA are set using TSLRIC, it is difficult to see what further adjustment may be required to give effect to the relativity consideration".[115]

251. This interpretation would render the relativity clause meaningless.

252. It also ignores Russell McVeagh's view that "when applying TSLRIC the Commission will have to make a diverse range of choices to determine efficient forward-looking costs …"[116] Section 18 and the relativity clause are both relevant considerations for any such choices and judgements. TSLRIC isn't simply a 'crank the handle' exercise.

253. Likewise, the view is also inconsistent with Telecom's concern that "Differential unbundling prices depending on whether a line is unbundled or not will create incentives to cherry-pick and this requires the Commission to give consideration to shifting all services (UCLL/UCLF/UBA) to a de-averaged tariff structure (which would require schedule 3 reviews of the UCLF and UBA service descriptions".[117]

254. Telecom has suggested that even if a UBA MEA, based on FTTH, reduced UBA costs to "negligible" levels "as long as efficient costs have been signalled the purpose of the Act is being met because of the FPP will signal efficient costs (as opposed to sustaining a particular technology or business model where this is inefficient)".[118]

255. What would the result be of a Commerce Act 1986 investigation into a pre-split Telecom setting a negligible price difference between UCLL and UBA services if these services weren't regulated? This question cannot simply be answered by the TSLRIC exercise. The Commission would need to investigate whether the pricing resulted in an

---

[112] Chorus, Submission in response to the Commerce Commission's Further consultation on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle – Consultation Paper (14 March 2014) and Supplementary Paper (25 March 2014), 11 April 2014, paragraph 148.
[113] Vodafone, Comments on further consultation papers on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle, 11 April 2014, paragraph D3.
[114] Telecom, UCLL and UBA FPP: further consultation and supplementary paper, 11 April 2014, paragraph 46.
[115] Russell McVeagh, advice to Telecom, UCLL and UBA Final Pricing Reviews, 30 April 2014, paragraph 36(a).
[116] Russell McVeagh, advice to Telecom, UCLL and UBA Final Pricing Reviews, 30 April 2014, paragraph 20.
[117] Telecom, cross-submission, UCLL and UBA FPP: further consultation and supplementary paper, 30 April 2014, paragraph 50a.
[118] Telecom, UCLL and UBA FPP: further consultation and supplementary paper, 11 April 2014, paragraph 32.

anti-competitive price squeeze. This is one feature of the relativity clause in the Act. The core purpose of the Telecommunications Act is to "promote competition".

Our table of issues not sufficiently dealt with in the framework paper

256. Those issues are now set out in tabular form. We have noted above that, while we observe the need to re-consult, this might be done pragmatically with less intrusion on time (such as on consultation on a draft model reference paper). To be clear, it is noted that it will be necessary to undertake the actions below one way or another: in particular, we note:

a. Most issues would need to be revisited, then put into some sort of form, including referencing and dealing with submissions, that enables consultation;

b. It will likely be too late to do that, for example in a draft determination or the paper expected in December, for the timing reasons outlined above;

c. There are numerous follow on issues we cannot deal with in light of the approach and they would need to be consulted on. For example, in view of its interpretation of the Act that a copper MEA is the only option for the UBA uplift, if the Commission, having revisited the issue as it must due to the consultation breach, decides that our submission is correct and a fibre MEA is legally possible for the UBA uplift, it would then be necessary to consult also on the issue of comparative costing and choices between a fibre and a copper MEA for the UBA uplift. In light of the conclusions in the framework paper that is not currently relevant.

257. This list of issues, which is not complete, implies that there may well be other serious concerns that have not yet surfaced. It may assist for the Commission to review the position.

258. Not all issues in the list are dealt with above, as the item is self-contained below (or the reference to a para above is only partially deals with the issue).

	Issue	Reference in 9 July consultation paper	Problems	Remedies	Cross ref in this submission
1.	Use of "reasonable investor" and "predictability" concepts under s 18	80, 86, 118-127	-approach adopted without reason (seems to be by error as there is no prior reference to this beyond the IM judgment in a different statutory context) -contrary to Act including s 18 - s 18 wrongly applied to cost-only issues -absence of evidence and analysis	-having considered views in current submission round, reformulate and reconsult	172, 173 Reasons (65-102) Evidence (103-105) Section 18 (136-173)
2.	Mobile MEA elements, (and mobile/FWA optimised)		-Paper dismisses mobile elements in MEA giving little reason. -VF Supreme Court case strongly points to Commission considering mobile MEA in more detail. Ditto as to optimisation of the FWA and/or mobile footprint which should not be limited to the current RBI footprint (wireless footprint should be optimised to extend over appropriate parts of DSL actual footprint).	Draft consultation paper and reconsult.	60, 113-121 Reasons (65-102) Evidence (103-105) -

			-Insufficient evidence to justify choice of MEAs -failure to deal with submissions at (eg Orcon sub of 30 April at [7])		
3.	Model network against counterfactual of existing UFB networks (Chorus and LFCs)	140-149, 268	-current approach inconsistent with Act -Paper does not address submissions at [3] Wigley 30/4	-Address position in draft form and reconsult	120-121 Reasons (65-102) Evidence (103-105) Section 18 (136-173)
4.	Role of Commission is to determine TSLRIC (a cost based price) and not the efficient price from a dynamic and static perspective	-eg 56	-incorrect application of Act -contrary to submissions, ignored such as on s 18 and in detailed areas such as [9] Wigley 30/4	-address position in draft form and reconsult	168-171 Reasons (65-102) Evidence (103-105) Section 18 (136-173)
5.	Section 18	54-65, 80, 86, 107, 109-127, 147, 180, 197, 207, and multiple consequential references	-approach contrary to Act and authority -Section 18 Submissions not dealt with (eg Orcon cross sub on issues and processes paper, including HC sub provided at same time) -insufficient evidence and analysis such as quantitative CBA	-remedy position and reconsult	Reasons (65-102) Evidence (103-105) Section 18 (136-173)

			-submissions on evidence and analysis not dealt with.		
6.	Network being modelled should be only the DSL capable network and not the full copper network including beyond the DSL footprint	101,102, 191	-Current position contrary to Act and Commission has not dealt with ignored submission contrary to this eg Orcon 11/4 at [2] including [2.11]Wigley 30/4 [12] and other submissions made by IntNZ, Orcon and Callplus. The submissions include that services and service boundaries need to be carefully analysed. - Additionally at [101] and [102] of its draft FPP framework paper, the Commission has applied the Orcon 11/4 sub at [2.11] incorrectly and in the wrong context. This implies that [2] in the Orcon 11/4 sub has not been fully read and applied. -Commission wrongly assume full network modelling is supported by all when it is not (at least that appears to be what is being said: this is not clear in view of the use of words that have different meaning in context: it would help if the Commission carefully defines the words it is using (eg	Address position in draft form and reconsult.	40 114 43-49 Reasons (65-102)

			UCLL can mean the service that is NCUCLL and SLU or it can mean what is known as NCULL; UCLL is used interchangeably by the Commission). Definitions should also carefully state delivery boundaries, etc.		
7.	Insufficient evidence used and insufficient analysis	-	-the courts require more detailed evidence -Paper does not address submissions on the point (eg Orcon and Callplus sub dated 11 April 2014, cross-referring to Orcon sub on WACC dated 28 March).	-address submissions and reconsult -obtain sufficient evidence eg as to s 18 analysis	232. 233 (but these are only limited examples) Reasons (65-102) Evidence (103-105) Section 18 (136-173)
8.	UCLFS treatment	186	-Telecom's interpretation not available under Act -Paper does not address submissions on the point at Wigley 30/4 [10] and [12]	Address position and reconsult	Reasons (65-102)
9.	Scorched node v Scorched earth	153	-Submission (at Wigley 30/4 [2.1]-[2.26]) that Act requires scorched earth dismissed in only three sentences and incorrectly. The primary issues, over three pages of submissions, not addressed at all or incorrectly (eg argument	Redo reasons and reconsult	Reasons (65-102) Evidence (103-105)

			that scorched node is not legally available not addressed and not enough to refer to generic conclusion) -breach of obligation to sufficiently and correctly deal with submissions (here, that the Act requires scorched earth to avoid historical cost) -no comparative analysis of scorched earth v scorched node MEAs done.		
10.	Pricing of one off charges	-	The FPP process requires this as it is part of FPP applications, but there is no reference yet to their treatment. [11] of Orcon's 11 April submission is not dealt with	Develop consultation material and a plan. It is recognised that this issue does not have to be dealt with in the draft FPP framework paper, but the silence thus far on this issue, it having been raised, is increasingly of concern.	Reasons (65-102)
11.	Dynamic efficiency trumps static is assumed, without evidence	58	-contrary to authority such as the IM decision: evidence and analysis is needed. -submission on the point ignored (eg Orcon 29/3 sub on WACC relied on in Orcon and Callplus 11/4 FPP sub).	Rectify and reconsult	111, 132-134 Reasons (65-102) Evidence (103-105) Section 18 (136-173)
12.	TERA July report deals, in table form at several points, only with submissions up to	-	TERA have not considered all submissions and that failure ultimately impacts the Commission's duties as to reviewing and dealing with	TERA to redo the affected work; changes then to Commission material as the Commission approach builds on the TERA advice, and then re-consult.	40 Reasons (65-102)

	2014. It fails to consider later submissions (which also implies the report may be out of date)		submissions, including as to giving reasons.		
13.	Model MEA options	164, 180	-Supreme Court decision on VF and Telecom TSO requires it, as do the evidence and analysis requirements outlined above. -Submissions ignored (eg Orcon sub of 30 April at [7])	Model relative costs and viability of alternative MEAs, to include (a) scorched node v scorched earth (b) footprint of hypothetical network (eg wireless not just over RBI footprint and (c) asset options eg poles v ducts.	125, 126, 149 Reasons (65-102) Evidence (103-105) Section 18 (136-173)