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By email

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## The use by the Commission of different MEAs when calculating TSLRICs for UCLL and UBA

### Summary

1. In its draft pricing review determination for Chorus's unbundled bitstream access service ("UBA"), the Commerce Commission ("the Commission") has used a different model to determine the price for Chorus's unbundled copper local loop ("UCLL") network than the modern equivalent asset ("MEA") model it used to determine the price - using the TSLRIC final pricing principle ("FPP") - for Chorus's UCLL service.
2. This approach is not tenable.
3. The Telecommunications Act 2001 ("the Act") requires that the applicable UCLL price, and the model used to determine that price, (in this case, the UCLL FPP price/model determined through a MEA analysis) is used as the first of the two components which together make up the UBA FPP price. It is contrary to the Act, and therefore a judicially reviewable error of law, for the Commission to determine the UBA FPP price by using as the first component for the UBA FPP price a different price/model derived from Chorus's existing unbundled copper local loop network, as the Commission proposes to do in its UBA FPP draft determination.
4. It is not a case of saying that different interpretations of the Act are available and that one should be favoured over, or is more rational than, others. Rather, it is a case of statutory interpretation for which there is only one right answer; an answer that the Commission has not referred to at all in its UBA FPP draft determination.
5. This advice, prepared together with Matthew Smith, barrister, explains this fundamental point.

### Analysis

6. Schedule 1 Part 2 Subpart 1 of the Act provides that the UBA FPP price is to be made up of two components: (i) "The price for Chorus's unbundled copper local loop [UCLL] network"; plus (ii) "TSLRIC of additional costs incurred in providing the unbundled bitstream access service".
7. On a plain meaning reading of the UBA FPP formula, the focus of component (i) is clearly on the "price for" Chorus's UCLL network. This reflects the nature of the exercise, i.e. to determine an appropriate UBA price increment on top of the price that has been determined for the UCLL.
8. "Chorus's UCLL network" is not defined in s 5 of the Act. But it is defined under the subheading "description of service" in Schedule 1 Part 2 Subpart 1, which prescribes the way in which prices for access to this service are to be derived (modelled). Read alongside that definition,

the UBA FPP formula reference to the “price for” Chorus’s UCLL network operates as a cross-reference to the UCLL price set through the “Chorus’s UCLL network” definition in Schedule 1 Part 2 Subpart 1, incorporating by reference that price and the model (i.e. the MEA analysis) through which that price has been determined. Practically this means that:

- (a) If a UCLL IPP price has been set, and that price has not been challenged by anyone, then the component (i) input into the UBA FPP price formula will be the UCLL IPP price.
- (b) If the UCLL IPP price has been set and is being challenged through the UCLL FPP process (as here), then the component (i) input into the UBA FPP price formula will be the UCLL FPP price that the Commission determines through the UCLL FPP process.

In other words, the model by which the Commission has determined the IPP/FPP price (as the case may be) for UCLL will then be used to inform the UBA FPP component (i) input.

9. In this way, the price for Chorus’s UCLL is the price set for that service using a model prescribed by the Act and then that model and its price are the starting point for considering whether any additional costs – and if so the price of them – are incurred in providing the UBA service. The actual price of Chorus’s UCLL doesn’t come into it. The Act doesn’t work on that basis.
10. Accordingly, the only tenable interpretation of component (i) of the UBA FPP in the present circumstances is that it is the price determined by the Commission using the TSLRIC FPP for the UCLL, i.e. the forward-looking costs of that service over the long run using the MEA model that the Commission has developed to determine that.
11. As well as according with the Act’s plain meaning, this interpretation has the following features:
  - (a) It gives effect to the intention of Parliament: Adopting the necessary purposive interpretation, it is apparent that Parliament has prescribed IPP and FPP models to set a fair and efficient UCLL price. Given their nature and purpose, those models and prices should be used as widely as possible across the Act.
  - (b) It ensures internal consistency within Schedule 1 Part 2 Subpart 1: There are at least three dimensions to this point. They are that the approach advanced:
    - (i) Means that the UCLL model and the resulting price, which has been set by the Commission in the manner Parliament has prescribed, will apply consistently across Schedule 1 Part 2 Subpart 1 of the Act. The importance of achieving internal consistency of this kind is evident in Parliament’s decision to tie the UBA price the Commission sets to the UCLL price (and vice versa).
    - (ii) Minimises the risk of using different modelling assumptions and inputs for common costs. Inconsistency of that kind, obviously, is to be avoided.
    - (iii) Minimises the risk of not ensuring relativity between Chorus’s UBA service and its UCLL network service, as the Act requires. The “additional matters that must be considered regarding the application of section 18” in the Schedule 1 Part 2 Subpart 1 sections of the Act entitled “Chorus’s UBA” and “Chorus’s UCLL” mirror each other in requiring the Commission specifically to “consider” the relativity between these two services when setting the price for each.
    - (iv) Minimises the risk of Chorus recovering costs that it is recovering in relation to another service, contrary to Schedule 1 clause 4B<sup>1</sup>.
  - (c) It produces outcomes which accord with common sense: A UCLL model and price accepted by everyone (i.e. a UCLL IPP model/price which is not challenged through the

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<sup>1</sup> As mentioned in paragraph 43 of Dr James Every-Palmer’s opinion for the Commission of 12 March 2014, the Commission is required to consider the fit between a new FPP price and the price which applies under other STDs, including a consideration of common costs.

FPP process) will supply the component (i) input to the UBA FPP price formula and will influence materially the UBA FPP component (ii) modelling exercise. That makes good sense, and ensures the Act works in a realistic and practical manner.<sup>2</sup>

- (d) It results in the most efficient allocation of time and resources: It relieves the Commission and parties to the UBA FPP process from having to devote time and resources to developing and populating a new model for determining the component (i) input to the UBA FPP price, and reduces the work that will be required to model the component (ii) input.

12. The analysis that the Commission relies on for its interpretive approach is unpersuasive:

- (a) Neither the words of the UBA FPP formula nor the Act's scheme support the approach of the Commission in paragraphs 227 to 234 of the UBA FPP draft determination. It is not logical for the Commission to say that the words of the Act constrain it to presuppose Chorus's copper access network and to only apply TSLRIC and MEA principles in relation to the additional costs of UBA. Different modelling assumptions are not prescribed for each service and there is no basis upon which the Commission needed to approach the task of pricing each service separately. As set out above, it is quite clear that the starting point for the UBA FPP is the price set by the Commission for the UCLL using the pricing method prescribed by the Act to determine that price.
- (b) The existence of a "staggered set of services", and the Commission's related concerns to incentivise unbundlers so as to allow access seekers to compete with Chorus in relation to the UBA service and to provide for a "ladder of investment", and for appropriate relativities,<sup>3</sup> do not justify discarding the model/price Parliament has prescribed as the fair and efficient model/price for determining the price for access by access seekers (RSPs) to the UCLL network; a price which of itself will involve implementation of and therefore reflect the s 18 purpose.<sup>4</sup> If properly set FPP prices do not deliver relativity, then so be it – that is simply a function of the scheme of the Act. Moreover:
- (i) The Commission can use s 18 to make price adjustments for the services to create any appropriate relativities and incentives.<sup>5</sup>
- (ii) Incentivising unbundlers must not become an end in itself over and above the Commission's primary duty under s 18(1) of the Act, which is to promote competition for the long term benefit of end users.<sup>6</sup>
- (iii) In any event, less weight should be given to incentivising unbundling in light of 2011 amendments to the Act which were expected to dis-incentivise further unbundling in urban areas, with existing unbundlers being protected to some degree by transitional arrangements applying until 2014.<sup>7</sup>

## Implication

13. Because the issue here is one of statutory interpretation for which there is only one right answer (i.e. there is no discretion on the Commission's part to choose between a range of available interpretations), the fact that the Commission has undertaken UBA work to date on

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<sup>2</sup> As the Court of Appeal in *Chorus v Commerce Commission & Ors* [2014] NZCA 440 said, at [43], the various provisions relating to the determination of the UBA price and the requirements of ss 18 and 19 should be read together to ensure that the legislation works in a realistic and practical manner.

<sup>3</sup> UBA FPP draft determination at paragraphs 233 to 235 and 393 to 411.

<sup>4</sup> *Chorus v Commerce Commission & Ors* [2014] NZCA 440, at [153] to [155].

<sup>5</sup> A point mentioned by Dr James Every-Palmer in paragraph 33 of his 12 March 2014 opinion for the Commission.

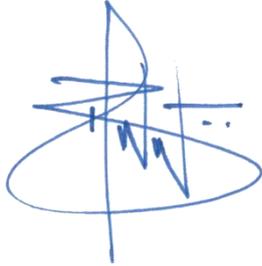
<sup>6</sup> See also on this point the UBA FPP draft determination at paragraphs 410 to 411.

<sup>7</sup> As mentioned by the Commission in the UBA FPP draft determination at paragraph 408.

an incorrect interpretation of the Act does not justify the Commission continuing on its erroneous approach for the (pragmatic) sake of that.

14. It is important that the model used for the UBA FPP is adjusted now in accordance with the Act, both in terms of completing correctly the current pricing determinations and in terms of the future operation of the Act.

Yours sincerely

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**Paul Radich QC**