Wigley + Company solicitors

Cross-submission in relation to UCLL and UBA draft pricing review determinations

24 September 2015

Level 6, 23 Waring Taylor Street, Wellington 6011 | PO Box 10842, The Terrace, Wellington 6143
Shed 20 Princes Wharf | Auckland 1149 | New Zealand
Wellington. +64 (4) 472 3023 | Auckland. +64 (9) 307 5957 | www.wigleylaw.com

Table of Contents

1. Introduction and Summary

Introduction

1.1 We deal first with monthly charges, and then with backdating.

Sapere, consumer welfare, total welfare and s 18

1.2 Sapere have submitted with a legal analysis as to how they think s 18 should be interpreted (along with some economics) in relation to consumer welfare, total welfare, or some variant of that, being the relevant test under s 18. They conclude that total welfare should be used when applying s 18.

1.3 That legal analysis is outside their area of expertise. But we have responded below to their arguments. Sapere have also not, as experts, drawn the Commission's attention to pivotal material they would be aware of and familiar with, that is against Chorus' position. Moreover, it is hard to reconcile what they say here (total welfare is available under s 18) with what they said for Vector on the 2014 energy WACC uplift debate (total welfare is not available).

1.4 Sapere populate their submission with broadly stated propositions without supporting evidence including on the very points on which this was criticised by the High Court (and that fed into the Commission's IM decision to revisit energy WACC uplift in 2014). The High Court was clear that such an approach is not acceptable. The Commission should treat the Sapere submission in this way (quoting from the IM High Court judgment):

> Where a proposition is simply asserted by economic experts, we give it little or no weight.[1]

1.5 We demonstrated in our 11 May submission why the total welfare test is not legally available, and nothing Sapere has raised changes our view.

1.6 The approach must be carefully based on the words of the Act (promoting competition in the LTBEU) and not upon economic concepts such as consumer and total welfare. Those concepts inform the approach: they do not dictate which appears to be Sapere's submission. Under s 18 the approach is more akin to consumer welfare, to include an assessment of both static and dynamic efficiencies. If the latter cannot be quantified (we say that it can be quantified and there is precedent from which the Commission cannot legally depart) the Commission can use producer surplus as part of a proxy approach: we agree with the Commission in that regard, and here it has correctly concluded that there should be an uplift. A proxy approach must use considerable caution.

"Classical" TSLRIC

1.7 The Chorus and Sapere views on "classic" TSLRIC are incorrect and do not comply with the Act's requirements.

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

Substantive problems with modelling, transparency and reasons

1.8 It is apparent from other submissions, particularly the expert reports provided by Network Strategies and WIK, that:

(a) there are substantial problems with the TERA modelling;

(b) the Commission and TERA have not adequately engaged with submissions on the modelling;

(c) the modelling and the revised drafts still lack adequate and necessary transparency or reasoning; and

(d) the revised drafts are not central estimates (they are biased upwards).

1.9 The expert reports provided by Network Strategies and WIK make it apparent that a lot of the modelling changes made since the December draft are non-transparent, have not been explained or simply do not make sense.

1.10 Among other things, this raises the concern that the Commission is not adequately dealing in writing with submissions.

1.11 A number of these concerns are listed in the Appendix.

Draft decisions produce undue generosities and excessive prices

1.12 The above conclusion remains, based on the WIK and Network Strategies reports.

Historic costs not ORC for re-usable assets

1.13 We explain why it is submitted that ORC is not legally available. In particular we set out a number of contextual matters which would be considered by a Court reviewing for error of law.

FWA

1.14 A smaller FWA footprint (or, in Chorus' submission, no FWA at all) is driven by the fact that FWA cannot be unbundled. That drives the price up substantially for reasons that are difficult to rationalise, viewed in the context of TSLRIC and s 18 objectives.

1.15 However that would produce an FWA footprint substantially smaller than an HEO would install. We outline the reasons why the footprint should be what the HEO would choose and that a solution can and should be found to derive UCLL and UBA prices.

Choice of UBA MEA

1.16 We outline why at law the copper MEA is not available in terms of choosing MEA on the required basis.

Concerns about the process

1.17 WIK and Network Strategies report the considerable number of changes to the modelling parameters between December 2014 and July 2015. Yet the statistically unlikely happens: the price ends up almost the same on those two

dates. Moreover, when a ground is withdrawn (as the Commission accepts it is not available), often there is no ultimate change as something fills its place.

1.18 This submission provides an analysis of how parameters have been moved up and down within blocks with the outcome that the price is largely unchanged since December.

1.19 Additionally, the Commission has effectively stated that it has made its decision on the cost model as at 2 July 2015.

1.20 That and other matters give the appearance that there has been and will be no ultimate change. Concerns are indicated.

TSLRIC prices should not be levelised

1.21 Chorus has reversed its position at the conference and now asks for prices to be levelised over the 5 years.

1.22 Chorus argues for this as it has the "advantage of simplicity".

1.23 However, there are no material simplicity gains, if any, to be had.

Backdating

1.24 Chorus says that the Commission must backdate to 2012 as the Commission must apply the 2006 Court of Appeal judgment. However, as explained by us and by the Commission's external legal adviser, that judgment is obiter, including as to whether there can be backdating and as to when backdating must go back to. (We also still submit that, at law, there can be no backdating.). Chorus never engaged with that submission and that advice and cannot now contend the judgment is binding.

1.25 Further, the facts and the legal position have changed since 2006, such that the judgment would not be binding anyway, and a different result would be reached – so that there should be backdating.

1.26 A key point is that Chorus incorrectly conflates (a) an efficient price (being the least cost incurred by the HEO), with (b) the full static and dynamic efficiencies analysis (such "efficiencies" being different to an "efficient" cost). An "efficient" cost is a factor in the broader efficiencies analysis and an "efficient" cost, alone does not meet the s 18 requirements.

1.27 We show that the Commissions submissions to the Court of Appeal, the industry letter to the Minister, and that some RSPs increasing their retail prices do not support backdating. We also show why Sapere's "time-consistency" submissions do not show that there should be backdating.

Insufficient reasons given by Commission

1.28 Our August 2015 submission remains that the Commission has not sufficiently addressed submissions made in writing (to be clear, all submissions and reports by RSPs (including Spark, Vodafone and their experts) not just by and on behalf of our clients. Among other things, the draft documents are not draft determinations under the Act.

1.29 In our August 2015 we used as a case study the fact that the Commission has completely overlooked dealing with our 11 May 2015 at all (that extends beyond

dealing with the submission in writing). An example of the effects of that error is the approach by Sapere when dealing with consumer v total welfare (our first topic below), without regard to the submissions that, legally, total welfare is not an option under s 18. Another relates to relativity and the UBA MEA. There are other topics too.

Structure of this cross-submission

1.30 The first part of the submission deals with monthly pricing. In the second part, we deal with backdating, particularly by responding to the Chorus submission.

1.31 As noted above, the appendix lists issues (not all of them) where it is submitted that the Commission has not engaged adequately in writing with the WIK and Network Strategies reports, contrary to the Act's requirements.

2. Sapere, consumer welfare, total welfare and s 18

Background

2.1 Sapere undertakes an analysis of how it believes s 18 should be interpreted and applied, in regard to consumer welfare, total welfare, or a mix of the two. The issues raised by Sapere have an impact across all matters where s 18 falls to be considered, given the need, as we have submitted, for a consistent approach to s 18 on all issues, from WACC to choice of modelling options. We have also submitted that:

(a) The circumstances in which s 18 is applied are limited (mostly, the Commission can resolve its approach by TSLRIC modelling without resort to s 18);

(b) So far as possible, an evidence based quantified analysis is required; and

(c) Even dynamic efficiency aspects of the analysis can be quantified, as the Vertigan report demonstrates.[2]

2.2 Sapere concludes that a total welfare approach is appropriate under and permitted by s 18. They do not however address our 11 May submissions that, legally, a total welfare approach is not available under s 18. Nor did Chorus address those submissions.

2.3 We will deal with the Sapere submission in the following order:

(a) An outline of Sapere's submission at a high level;

(b) Then we interpose three key matters:

(i) Sapere are expert economists not expert lawyers;

(ii) The IM judgment requirement that there can be no general statement of applicable economic principle, absent careful justification on the evidence (a requirement that Sapere's submission extensively and repeatedly breaches).

(iii) A high level interpretation of s18, before turning to the detail.

[2] As discussed in Wigley and Company, Commentary on behalf of consumer interests on Commerce Commission paper dated 2 April 2015 as to TSLRIC and WACC uplifts, 13 April 2015,

(c) We summarise our submissions where they are relevant to the Sapere submissions;

(d) We then address Sapere's submissions and we analyse and cross-submit on them.

Sapere and consumer v total welfare

2.4 Sapere[3] stated in their 11 August 2015 submission, having noted that s 18 provides the compass for the Commission's decisions under Part 2:[4]

> We apply an economic lens to section 18. We explain why a total welfare, or economic efficiency, interpretation of section 18 provides an internally consistent interpretation of Part 2. However, section 18 does not provide an economic basis for making the allocative choices required under a consumer welfare standard.

2.5 That submission is expanded upon by Sapere. Based on their interpretation of the law and of their view on the economics, they say that the correct approach to this issue is that of the total welfare test.[5]

Sapere's expertise is as economists not as lawyers

2.6 Welcomed is that Sapere reports as experts having agreed to the Code applicable to experts. That means, in the words of the Code, they acknowledge "…the evidence is within the expert's area of expertise".

2.7 Sapere are economists not legal experts, and can only give evidence and report, and be relied upon by the Commission as such experts, as economists.[6] Chorus has elected not to provide legal submissions/reports from, for example, Chapman Tripp (noting Tim Smith from Chapman Tripp submitted verbally on these issues at the conference).

2.8 Despite Chorus allowing Sapere to stray well outside their area of expertise, we respond to the Sapere legal analysis.[7]

General statements of principle do not suffice

2.9 One of the most telling features of the Sapere report, is that Sapere, who were heavily involved as experts for Vector in the Commission's 2014 review of the IM WACC percentile matter, rely, from the IM process, only upon the 2010 IM Reasons Paper.[8] They also submitted in that IM matter in detail on the same issues as are submitted upon here, applied to a Part 4 context. Two of the three authors overlap.

2.10 As is well known to Sapere (after all, they heavily submitted on the points), the 2014 review of the IM WACC uplift was driven by relevant criticisms by the High Court of the 2010 IMs issues Paper, being the only IM paper relied on by Sapere. A number of the criticisms were material to what Sapere is now submitting upon.

---

[3] At [5]
[4] At [4]
[5] Sapere Report dated 11 August at [3] – [7] and [33]-[47]
[6] As we have pointed out earlier, we are not submitting as experts, and these submissions are prepared using economics and legal expertise
[7] Primarily outlined by Sapere in their 11 August report at [38] to [46]
[8] And only at [44] of their 11 August 2015 UCLL and UBA submission

2.11 One of the requirements of signing up to the expert witness code is that the expert must assist the tribunal and provide dispassionate views, including as to points that are against their clients.

2.12 There is no reference to the IM judgment or the October 2014 Reasons Paper on IM energy WACC uplift even though Sapere are familiar with this material.

2.13 As we have submitted earlier, the High Court in the IM judgment was critical of the Commission for relying – in the 2010 IMs Reasons Paper - on broadly stated conclusions on economic matters. For example, the Court said (bold added):

> … **the Commission did remarkably little … to justify its assertions about the relative costs of over and underestimating the cost of capital** …[9]
>
> 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.**[10]
>
> … we have some sympathy with MEUG's submission that the Commission's approach to the asymmetric costs of over and underestimating the WACC lacks a solid basis.[11]
>
> **Where a proposition is simply asserted by economic experts, we give it little or no weight**.[12]

2.14 Sapere in its August submission on UCLL and UBA is doing precisely what the Court criticised the Commission for. It does not go on and provide any evidence or sufficient analysis (quantified or otherwise) to justify its broadly stated conclusions. It is therefore inviting the Commission to breach the Court's decision on those points, when it was involved in the IM WACC uplift and must have known of the reasons why the Commission revisited WACC uplift (due to the problems identified by the High Court).

2.15 Here are some examples of broad-brush approach by Sapere (there are a number of others as this is essentially the theme and approach in this part of the Sapere submission):[13]

> 48…As put succinctly by the current deputy chair of the Commission (prior to her tenure at the Commission):
>
> *"economists would generally agree that a market would promote long-term consumer welfare if it maximised the sum of producer and consumer surplus over time. Consumers gain when producers, spurred by the prospect of*

[9] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1440].
[10] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1462].
[11] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1470].
[12] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1745].
[13] With footnotes removed and bold added.

> *earning profits, enter markets, undertake investments and innovate to produce the goods and services that consumers want."*
>
> 49. The phrase 'long-term' recognises that an intervention to promote competition may not immediately benefit end-users, but that competitive processes over time will lead to benefits for consumers.
>
> **50. The Commission can therefore be confident applying a total welfare standard in workably competitive markets will promote the long-term benefit of end-users…**
>
> 52. For the same reasons as outlined above [at 48-50], **the Commission can be confident that applying a total welfare test to guide its analysis, when it regulates a service to promote competition in downstream markets, would lead to long-term benefits to end users…..**
>
> 57…**dynamic efficiency associated with new investment is, in most cases, likely to be of an order of magnitude more important than allocative efficiency concerns**

2.16 It is submitted that Sapere's report should, in the words of the IM judgment, be treated in the following way:

> Where a proposition is simply asserted by economic experts, we give it little or no weight.[14]

2.17 That is the position here and we submit that the Sapere report as to consumer v total welfare can be entirely dismissed as it is "a proposition [that] is simply asserted by economic experts".

Dancing on the head of a pin: interpreting s 18

2.18 Here we set out a high level approach to interpreting s 18. Later we move to the detail.

2.19 Everything in s 18 (including s 18(2A)) is **solely** about "promot[ing] competition in telecommunications markets for the long-term benefit of end-users of telecommunications markets".

2.20 This is not just a "long-term benefit of end-users" (LTBEU) test, for that omits components such as "promoting competition": the latter is particularly important for this FPP given Chorus is an upstream provider with substantial market power and the area for competitive rivalry lies most at the downstream RSP level. Largely, up or down Chorus UBA and UCLL price movements have RSPs floating with the tide, with little impact on competition (Note: these are high level observations and in the end it is the evidence and analysis that counts).

2.21 Even leaving aside the critical requirement that s 18 requires sufficiently quantified analysis, Sapere completely omits this facet of the markets when undertaking its analysis. It is as though Chorus is the only one to be incentivised to innovate/invest by higher prices when RSPs are also potential investors, including as to infrastructure that Chorus may invest in (a simple example is RBI2 and UFB2 where other RSPs (which pay the UCLL and UBA

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

charges) can tender to do those roll-outs). Why should Chorus get incentives to invest on say UFB2 or RBI2, and not others? There's 5G MNO roll-outs and so on. Many such investments fit within s 18(2A) but in any event within s 18(2).

2.22 Critically though, we are only raising issues to feed into a detailed analysis, if s 18 is to be used to uplift any aspect of the modelling factors feeding into the UBA and UCLL prices. If there is to be no uplift then the default position applies: central estimates on each issue should apply.

2.23 The Commission must of course interpret and apply the "promoting competition in the interests of LTBEU" test. Economic concepts such as total welfare and consumer welfare can only be a contextual aid when interpreting the words of the Act (and only if that is necessary, that is, the true meaning cannot be deduced from the Act overall). The Commission has recognised this, and to some extent Sapere does too, but Sapere seem to lapse into squeezing the words of the Act into economic concepts, not the other way around.

2.24 They even, wrongly, dance on the head of a pin, by addressing disputed interpretations of consumer welfare.[15]

Summarising our views on consumer v total welfare and interpretation of s 18

2.25 We summarise what we said in our 11 May submission – this is the submission we used as our case study where the Commission has completely overlooked the submission - augmenting this in light of the points made by Sapere:

(a) As above, s 18 is squarely framed as **solely** a "promoting competition in the LTBEU" test, including as to s 18(2A).

(b) So is s 1A of the Commerce Act too, if one looks only at that section.

(c) But the key material difference between the Telecommunications Act and the Commerce Act is that there is an addition to s 1A where there is no such addition to s18. Section 3A of the Commerce Act provides a public benefits test:

> Where the Commission is required under this Act to determine whether or not, or the extent to which, conduct will result, or will be likely to result, in a benefit to the public, the Commission shall have regard to any efficiencies that the Commission considers will result, or will be likely to result, from that conduct

(d) As we said in our 11 May submission:[16]

> S 3A of the Commerce Act focusses on "the public" (where there was established history of that referring to total surpluses) whereas s 18 focusses solely on end-users of telecommunications services. This different approach, and the different approach of making the efficiencies provisions (s 18(2) and (2A)) expressly part of the s 18 regime with its sole s 18 purpose, shows that the sole focus is the end user of telecommunications services and not the wider society (NZ Inc).

[15] Sapere 11 August report at [62]
[16] At [4.24]

> Thus it is the benefits and detriments only incurred by end users of telecommunications services that are material.

(e) By contrasting the different (and sometimes parallel) treatment in both Acts, we were able to conclude that:[17]

> Therefore, the different approach in the Commerce Act, far from supporting a total surplus test, supports the opposite conclusions: that there is only a consumer surplus test under s 18.

2.26 For the reasons above, our latter reference to a consumer surplus test overly truncates what is ultimately the "promoting competition for the LTBEU" test. However, what can clearly be said is that there is no role for the total welfare test, except as a proxy for efficiencies, in the manner we outline below.

2.27 For completeness, and as the Commission's UCLL and UBA approach in its cost of capital paper relies on the IM analysis, we also note that the Part 4 objective at s 52A differs also from s 18. Generally, s 52A – also qualified by a focus on long-term benefit to consumers – can encapsulate consideration of more considerations than is permitted under s 18. In its UBA and UCLL cost of capital paper, the Commission relies on the approach to WACC uplift from last year's IMs WACC percentile review. On the current basis, outlined below, we submit that the commonality is sufficient to take this approach but that may change if the Commission moves to more broadly include factors beyond its current approach.

2.28 We agree with the Commission that producer surplus (in effect, a component in total welfare) can be used, with caution, as a proxy for an unquantifiable long-term net benefit to consumers. That proxy however would only be a part of the producer surplus figure, in the exercise of judgment, as it is used for a specific purpose.

2.29 The Commission in the UBA and UCLL cost of capital paper has built upon the 30 October 2014 Reasons Paper as to the IM WACC uplift, in this way:[18]

(a) It summarised the 2014 Reasons Paper, as follows:

> 293.3 Therefore, notwithstanding our in principle view that using the consumer welfare standard is more consistent with an overall objective of the long-term benefit to consumers, it may be appropriate in practice to give some weight to producer surplus. However, this would only be to the extent producer surplus provides an appropriate proxy for some otherwise difficult to quantify (or unquantifiable) long-term (net) benefit to consumers, in particular as an indicator of the margin for error regarding incentives to invest.

(b) Then, it concluded, as follows, as to UCLL and UBA:

> 294. We consider that similar conclusions apply in the context of considering a WACC uplift for UCLL and UBA. In the long-term, section 18 directs us to consider consumer

[17] At [4.26]
[18] UBA and UCLL Cost of Capital Paper at [239.3] –[241]

> welfare, through reference to the "long-term benefit of end-users". However, in our view, total welfare may also be relevant where it incorporates long-term benefits to end-users not otherwise captured.
>
> 295. In practice, we are not convinced, in the quantitative models provided, that the differences between the total welfare and consumer welfare estimates were due to factors other than a transfer of wealth from consumers to producers. This leads us to the view that the consumer welfare standard is appropriate in this case. As noted above, this is consistent with the approach taken in the regulation of electricity lines and gas pipelines businesses.

2.30 The Commission went into some detail in the cost of capital paper on this issue, including its application to TSLRIC.

2.31 We have submitted that, with one major departure, the conclusion in the cost of capital paper, including the quantified cost benefit analysis by Oxera, is the approach that is applicable on all s 18 decisions as they all involve questions ultimately of increasing, decreasing or not changing central estimates. We have submitted that other s 18 decisions in the draft decisions do not meet the same standard of analysis, which is required under the authorities to which we have referred.

2.32 Our point of departure is as to the conclusion that use of the proxy for difficult to quantify long-term benefits to end users is required here. We have submitted[19] that the Vertigan quantified CBA demonstrates that (a) there is no justification for uplift and (b) that the effect upon consumer welfare can be quantified. The Vertigan committee were able to do that in 3 ways.

2.33 While the Commission has dismissed the Vertigan report on the basis that its purpose is different from the FPP TSLRIC determination, the report is relevant on the basis that:

(a) it details how migration benefits and externalities can be quantified (directly relevant to the question of whether an uplift should be granted)

(b) it provides a quantified estimate of migration and externality benefits in contrast to the 'guess' the Commission assumed in its uplift modelling, and

(c) it demonstrates that the Commission's assume migration benefits were excessive.

2.34 We now turn to the Sapere report.

The Sapere report and analysis of that report

2.35 We will not deal again with absence of analysis and evidence underpinning widely sweeping statements of principle, which we submit is fatal to Sapere's arguments. We add the point noted above, that the necessary quantitative analysis and evidence must consider the position, from the end-user's perspective, not just of the role of Chorus as potential investor but also the role

[19] Wigley and Company, Supplementary Submission on Commission's "Analytical Frameworks for Considering an Uplift to the TSLRIC Price and/or WACC", 11 May 2015.

of other industry participants such as RSPs, which might invest with available funds, including as to the same projects that Chorus might wish to invest in. We can see no valid reason why, as to say, RBI2 and UFB2, Chorus should get a head start (more available funds) instead of others that might tender for those projects. It is also not apparent why an upstream provider with market power (Chorus), where increasing its price has RSPs competing on a rising tide, should be paid more, **when the sole focus of s 18 is promoting competition.** It would be necessary to show empirically that paying more to Chorus promotes competition as between RSPs in the downstream markets. This may involve questions of pass through by RSPs, all to be quantified.

2.36 We turn now to other aspects of the Sapere Report. Sapere outline their understanding of the history and position under the Commerce Act – outside Part 4 - as to s 1A and the approach to total welfare, mostly correctly, from:[20]

(a) the *Air New Zealand v Commerce Commission (No 6)* passage (that we also quoted) a judgment that is often relied upon to show that the approach under the Commerce Act includes total welfare, despite s 1A's focus on consumers, through to

(b) the Commission's approach in the December 2010 Reasons Paper taking the total welfare approach (omitting however as noted above the subsequent High Court judgment criticising that Paper and the subsequent 2014 Reasons Paper).

2.37 Sapere draw these initial conclusions:[21]

> However section 18 of the Telecommunications Act does not include an explicit provision to limit the ability of suppliers to extract excessive profits; it simply refers to the long-term benefit of end users. Viewed through an economic lens, there is no reason to interpret the words "for the long-term benefit of end users" in section 18 to mean something different than the words "for the long-term benefit of consumers" used in section 1A of the Commerce Act. We therefore assess from an economic perspective whether a total welfare, or a consumer welfare, standard provides an internally consistent interpretation of section 18, beginning with the total welfare standard.

2.38 This seems to conclude that a total welfare test is an available option under s 18, although somewhat elliptically. But in any event, as noted above, Sapere conclude in its summary that a "total welfare…interpretation of section 18 provides an internally consistent interpretation of Part 2".[22]

2.39 As we have explained above, a standard statutory interpretation of the Commerce Act and the Telecommunications Act shows that, while the total welfare standard applies under the former (that is, outside Part 4 which has its own purpose statements), it does not apply under the latter, mainly because the latter has no equivalent of s 3A (and having regard to the legislative history too). Section 18 is explicitly and unambiguously framed solely in terms of consumer welfare (with no provision such as s 3A to change that position). When interpreting s 1A, the Court in *Air New Zealand v Commerce Commission (No 6)*

[20] Sapere 11 August report at [40] –[46]
[21] Sapere 11 August Report at [46]
[22] Sapere 11 August report at [4]

expressly noted[23] that the broader efficiencies test in s 3A was not removed by s 1A's focus on consumers.

2.40 The focus under the Telecommunications Act is solely on "promotion of competition in the LTBEU" and that is aligned broadly with the consumer welfare standard, a standard that can take account of dynamic efficiencies, from the perspective – solely – of the end user. The Commission might use a proxy (part of the producer surplus) if the evidence is not available. We say that it is available and, legally, the Commission can only uplift the price under s 18 if the need to do so is demonstrated by a quantified approach.

2.41 In the end, Sapere conclude on this point:

> 64. As the consumer welfare approach considers wealth transfers from consumers to producers as being harmful rather than neutral, it is more critical of efficiency claims. Interpreting section 18 as a consumer benefit standard would entail endorsing the view that in promoting competition for the long term benefit of end users, it is sometimes best to make everyone in society worse off. From an economic perspective, this would be a very different (and odd) interpretation of long term benefit

2.42 To which we comment:

(a) There are, again, sweeping and unsupported statements by economists, contrary to the IM judgment.

(b) If by "consumer welfare" they mean to exclude dynamic efficiencies that may be so, but the latter can be included (empirically in our submission, but the Commission is looking at using partial producer surplus as a proxy but no such net benefits have been demonstrated: thus no uplift).

(c) Total welfare is not a legal option under s 18.

(d) Assume for the sake of argument that this sweeping statement is correct: "everyone in society is worse off" by using the consumer welfare standard. If that is the effect of the Act so be it. The High Court on the IM judgment was explicit on the required approach, as summarised by the Commission in the IM energy WACC uplift reasons paper of October 2014.[24] The Court said:[25]

> "To use the wording discussed in *Powerco Limited v Commerce Commission*, the interests to be promoted here are those of the 'acquirers' of goods and services in the relevant markets, not the broader interests of those acquirers as participants in New Zealand's wider economy" and "the overall purpose of Part 4 is to promote the long-term benefit of consumers of regulated goods and services, and not the interests for example, of consumers of unregulated services or to provide more general incentivising effects which may be considered to be in the interests of the wider New Zealand economy"

[23] (2004) 11 TCLR 347 at [240].
[24] At Attachment A: [A5].
[25] At [222] and [686].

2.43 Finally, it is not clear to us why Sapere can submit that s 18 is to be interpreted as having a total surplus test, when, under s 52A (the Part 4 purpose statement, which is wider than s 18 as to what can be taken into account), it concedes no total welfare test is available. For Vector, in the IM energy WACC uplift consultation, Sapere submitted this: [26]

> We agree that the [s 52A] purpose statement cannot be interpreted as equivalent to a total welfare test.

2.44 There appear to be inconsistencies in the way submissions are presented in each enquiry.

Examples of other Commission reviews

2.45 By way of example, the outcome of the Commission's gas price control inquiry hinged on the treatment of wealth transfers and adoption of a consumer welfare standard e.g. the Commission noted that it "found NAB for all businesses investigated. The positive NAB has been driven by excess returns as the net efficiency effect of control is always found to be negative".[27]

2.46 By way of further example, similar observation can be made in relation to the mobile termination investigation. The Commission determined that approximately 95% of the benefits of regulation were from wealth transfers, and that (under a constant elasticity assumption) the total welfare and consumer welfare standards produced different conclusions.[28]

2.47 Consistent with the Commission's position that "The Commission uses the consumer welfare approach in considering the benefits and costs of regulation"[29] the Commission recommended regulation in both these inquiries.

3. "Classical" TSLRIC

3.1 Sapere assert that a "classical" or "orthodox" application of TSLRIC "is fit for purpose for this price determination", that "From an economic perspective we consider the Schedule 1 description of TSLRIC supports the use of classical TSLRIC" and a "classical TSLRIC is consistent with section 18".[30]

3.2 Sapere do not substantiate any of these assertions or attempt to refute any of the submissions made against the Commission's interpretation of, and application of, an "orthodox" TSLRIC. Sapere do not explain why advances and improvements to the way TSLRIC has been modelled should be ignored by the Commission.

3.3 Spark's views are supported as to the Commission's so called orthodox approach including that it "ignores the large body of Commission commentary on the importance of maintaining "international best practice". Incorporating developments in economic best practice over time is not inconsistent with predictability, it promotes it, because it is best practice".[31]

---

[26] Sapare, WACC percentile - cross submission, 12 September 2014, para [20].
[27] Commerce Commission, Gas Control Inquiry Final Report, 29 November 2004, para [20.6].
[28] Commerce Commission, Reconsideration Final Report on whether mobile termination should become a designated or specified service, 20 April 2006.
[29] Commerce Commission, Reconsideration Final Report on whether mobile termination should become a designated or specified service, 20 April 2006, para [270].
[30] Sapare, 12 September 2014 cross-submission at [69] and [70].
[31] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, para [3110].

3.4 Whether "recent innovations" or current methods should be adopted should be determined by whether it would result in a more accurate estimate of the cost of an HEO.

3.5 Key is s 6 of the interpretation Act 1999:

> An enactment applies to circumstances as they arise.

3.6 It is current circumstances that matter, including market conditions and TSLRIC principles, not such matters of old.

4. Substantive problems with the modelling and lack of transparency and reasoning

The problem

4.1 In summary, it is apparent from other submissions, particularly the expert reports provided by Network Strategies and WIK, that:

(a) there are substantial problems with the TERA modelling;

(b) the Commission and TERA have not adequately engaged with submissions on the modelling;

(c) the modelling and the revised drafts still lack adequate and necessary transparency or reasoning; and

(d) The revised drafts are not central estimates (they are biased upwards).

4.2 It is apparent from the expert reports provided by Network Strategies and WIK that a lot of the modelling changes made since the December draft are non-transparent, have not been explained or simply do not make sense.

4.3 The breadth of modelling issues and the severity of the criticisms raised by Network Strategies and WIK is of real concern.

4.4 WIK, for example, note that "Our model analysis demonstrates that there are many items where the model design and parameter changes are not adequate, sufficient or correct. Improvements that we have proposed, in many cases, have not clearly been addressed by TERA or the Commission".[32]

4.5 WIK goes on to say "Our analysis demonstrates significant changes in most model inputs. Many of the revisions have not been described or explained in the draft decision or the accompanying model description documents, despite having major impact on the final results ... For example, non-network related and common costs have changed dramatically since the 2014 model, without an obvious explanation. These changes have also not been checked for efficiency nor are they benchmarked".[33]

[32] WIK-Consult, Submission In response to the Commerce Commission's "Further draft pricing review determination for Chorus' unbundled bitstream access service" and "Further draft pricing review determination for Chorus' unbundled copper local loop service" including the revised cost model and its reference documents, 12 August 2015, para [10].

[33] WIK-Consult, Submission In response to the Commerce Commission's "Further draft pricing review determination for Chorus' unbundled bitstream access service" and "Further draft pricing review determination for Chorus' unbundled copper local loop service" including the revised cost model and its reference documents, 12 August 2015, para [11].

4.6 WIK provide a long list of substantive matters, including with (i) model and parameter changes; (ii) issues addressed without proper model changes; (iii) issues they raised which have been ignored; and (iv) new model errors and inconsistencies.[34]

Breach of duty to give reasons as to submissions

4.7 Consumer interests and smaller RSPs are, as we submitted in our August submission:

(a) highly dependent on the work done by WIK and Network Strategies in the particularly important area of the actual modelling (as that is outside their expertise and resources);

(b) relying on the Commission sufficiently addressing, in writing, their reports and submissions.

4.8 WIK and Network Strategies, as outlined above, have expressed deep concern about the approach, the lack of explanation for changes, etc.

4.9 This is an important facet of the concern that, as is submitted, the Commission has not met its legal obligations to deal adequately with submissions in writing, in both the draft and the final determinations.

4.10 If interested parties do not know what decisions the Commission has made, and/or the reasons for the decisions the Commission has made, then it isn't possible to properly or fully respond to the Commission's drafts. That is one of the key reasons why reasons requirements are put in legislation, as the authorities referred to you previously confirm.

Example - FWA

4.11 Comments made by Network Strategies on FWA provide a good example of the problems with the Commission's modelling. Network Strategies is in a strong position to comment on FWA given its previous TSO experience on the same matter:[35]

> The Commission appears unaccountably perplexed as to how it should identify where Fixed Wireless Access (FWA) should be deployed and how to choose which end-users should receive it. To solve this problem the Commission proposes a completely unorthodox and unrealistic method which assumes that the modelled operator will deploy fibre or FWA based on one factor only – distance from the exchange. The assumed distance seems to signify an adjustment for the performance of the copper network while neglecting the implications of geotypes and costs.
>
> … The modelled fibre extends to locations where it would be completely inefficient to deploy such a technology. These are areas where, as the Commission itself states, costs are particularly high and unbundling is unlikely.

[34] WIK-Consult, Submission In response to the Commerce Commission's "Further draft pricing review determination for Chorus' unbundled bitstream access service" and "Further draft pricing review determination for Chorus' unbundled copper local loop service" including the revised cost model and its reference documents, 12 August 2015, section 7.

[35] Network Strategies, Revised draft determination for the UCLL and UBA price review, 13 August 2015, pages I and ii.

> … A TSLRIC estimate of efficient costs inherently requires the choice of modern technology to be made on economic criteria, using as a yardstick the decisions that an efficient operator would make. The Commission explains its reluctance to adopt the requisite cost-based criteria for technology choice, on the grounds of potential model complexity. [emphasis added]

4.12 Despite substantive and credible evidence from Network Strategies on how FWA could be better applied in the TSLRIC model, the Commission simply makes the sweeping statement "Our view is that FWA should be used for lines where costs are particularly high and unbundling is unlikely – our judgement is that, on balance, the number of customers fed by RBI felt about right".[36] The Commission fails, it is submitted, to adequately engage with the substantive evidence provided by Network Strategies in any meaningful way, basing its draft decision on assertion and unsubstantiated judgement.

4.13 If interested parties do not know what decisions the Commission has made, and/or the reasons for the decisions the Commission has made, then it isn't possible to properly or fully respond to the Commission's drafts.

Concerns outlined in appendix

4.14 In the appendix, we have summarised some of the points where the Commission has not engaged sufficiently in writing with the WIK and Network Strategies material.

5. Draft decisions produce undue "generosities" and excessive prices

5.1 Our earlier submissions expressed concern that the draft decisions did not reflect genuine "central estimates" of TLSRIC, but rather contained "generosities".[37] This was reflected, for example, in Network Strategies' comment that "Our review of the Commission's key model assumptions indicates that the calculated point estimates in fact approach an upper bound".[38]

5.2 Of concern from its August 2015 submission, Network Strategies now considers "the model encompasses inefficiencies" and "Our review indicates that the calculated point in fact is **beyond an upper bound estimate** as it is does not reflect efficient MEA (Modern Equivalent Asset) costs" [emphasis added].[39]

5.3 The Commission responded to Spark's Manhattan graph and the campaign by commissioning TERA to undertake some benchmarking analysis which suggested New Zealand's population density, population dispersement, network length per customer, and trenching costs compared unfavourably to our international peers.

5.4 WIK has addressed the TERA conclusions and, for what appear to be straightforward reasons, show that the analysis at best would only explain a small amount of the 80% differential. As summarised by Spark "WIK found, despite taking care to make a conservative estimate, that the cost from the

[36] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, para [207].
[37] For example: Wigley and Company, Cross submissions as to draft UCLL and UBA FPP determinations, 20 March 2015, para [1.1].
[38] Network Strategies, Final report for Spark New Zealand and Vodafone New Zealand - Commerce Commission Draft Determination for UCLL and UBA - A review of key issues, 20 February 2015, page i.
[39] Network Strategies, Revised draft determination for the UCLL and UBA price review, 13 August 2015, page i.

Commission's model is some 65% higher than the cost estimate based on the Swedish model adjusted for New Zealand-specific inputs".[40]

6. Chorus' incentives to invest arguments hinge on drafts setting prices below cost

6.1 The previous section illustrated that the revised drafts include "generosities" and are likely to be well above Chorus' actual costs (which Professor Vogelsang confirmed).

6.2 Chorus makes a number of claims which are contrary to strong evidence, as backed up by the Commission and its own experts, that the TSLRIC prices, and the draft decisions, contain generosities.

6.3 For example, this is seen vividly by the Commission's observation that "the asset values for UCLL and UBA used in our further draft determinations total approximately $6.6 billion, which is significantly greater than Chorus' enterprise value (ie, the value placed by the market on all of Chorus' business activities). Chorus' total enterprise value (including services not covered by UCLL/UBA regulation, such as UFB) is approximately $3.3 billion"[41] and "Chorus may have accumulated gains from providing UCLL over time".[42]

6.4 In a similar vein Ingo Vogelsang has noted "The TSLRIC method currently proposed by the NZCC is likely to be substantially more than needed by Chorus for covering the cost of its copper access network. Thus, the copper access network is likely to remain highly profitable."[43]

6.5 Chorus alleges, in contrast, "regulatory opportunism" against the Commission, on the basis that "It says that at the time investment and innovation is made, it should be assumed that the investment and innovation may be immediately treated as sunk and unworthy of an appropriate return".[44]

6.6 Chorus also claims "In many instances, the Commission has also chosen the lowest cost option from a range of nationwide costs when deciding on particular modelling parameters. For example, the Commission has taken the lowest price for accessing electricity lines company poles and assumed that this price can be achieved nationwide".[45]

6.7 In order for the TSLRIC price to be 'too low', or for the revised draft to impact on Chorus' incentives to invest, the revised drafts would need to preclude Chorus from being able to earn, at least, a normal return on its prudent and efficient investment. Setting draft prices well above actual cost is not "regulatory opportunism".

---

[40] Spark, Further draft pricing review determination for Chorus' UBA and UCLL services, 13 August 2015, para [8].

[41] Commerce Commission, Cost of capital for the UCLL and UBA pricing reviews, 2 July 2015, paras [313.1] and [313.2].

[42] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, draft determination, 2 December 2014, para [643].

[43] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, para [24].

[44] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 July 2015), 13 August 2015, page 5.

[45] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 July 2015), 13 August 2015, page 8.

6.8 Chorus has provided no evidence that it would not be able to recover its costs or expect to be unable to earn at least a normal return. Chorus is repeating the same mistake regulated suppliers made in the Part 4 IMs Merit Appeal case where it was argued that that RAB IM set asset values too low and would undermine incentives to invest. We have made this point several times through the FPP determination consultation process, which Chorus has not responded to, but repeat our commentary from the April conference:[46]

> I just want to emphasise in terms of the concerns that Chorus keeps on raising about incentives to invest, the important thing is that investors have confidence that they can expect at least normal return on their prudent and efficient investment, and Chorus has provided no evidence to date that the Commerce Commission's draft decision would not provide that, and there has been a fair bit of evidence that the TSLRIC draft decision will actually provide a price that will be well above Chorus' costs. So, if Chorus wants to persuade the Commerce Commission that there should be a higher, an uplift in the WACC or anywhere else, then the onus is on Chorus to demonstrate that the draft decision would preclude it from earning a normal return. And, as I mentioned on Monday, exactly the same issue came up in the Part 4 merit appeal where the RAB was challenged because it was too low and because it would not incentivise investment, and the High Court decision was that if that argument was going to be persuasive, then the regulator to suppliers needed to provide evidence that the RAB or the Commerce Commission decisions would preclude them from earning a normal rate of return. As with Chorus the regulated suppliers did not or were unable to do so.

6.9 In terms of Chorus' specific, and qualified, comment that "In many instances, the Commission has … chosen the lowest cost option …"[47] we reiterate TSLRIC is supposed to be based on the cost of a hypothetical efficient operator, which it would be reasonable to presume would select the least cost MEA options, so it should be expected that the Commission would select the "lowest cost option".

6.10 The issue is not that in some or "many instances, the Commission has … chosen the lowest cost option" but that in many material decisions it has not selected the lowest cost option. This is highlighted by choice of ORC rather than historic cost for re-usable assets (the later would reduce the draft UCLL price by at least 9%),[48] and the limited optimisation and use of FWA the Commission has applied in the modelling.

6.11 The one element of common ground between Chorus and our RSP and consumer representative clients is that "The historic costs of network deployment … are irrelevant in calculating a forward-looking long run incremental total cost of the service … forward-looking costs reflect the costs that a network operator would incur if it built a new network today using assets collectively referred to as the modern equivalent asset".[49] This counts against backdating (which isn't forward-looking), use of Chorus' actual costs (including asset lives), limitations on optimisation (scorched node) which rely on Chorus' actual network configuration, artificial limitations on MEA such as FWA where it

[46] UCLL and UBA Services Final Pricing Principle Conference held on 15-17 April 2015, Transcript, pages 368-9.
[47] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 July 2015), 13 August 2015, page 8.
[48] Commerce Commission, Cost of capital for the UCLL and UBA pricing reviews, 2 July 2015, para [313.1].
[49] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 July 2015), 13 August 2015, para [62].

is the lowest cost supply option, and valuing assets at replacement cost that won't be replaced.

7. Cost of re-usable assets

Introduction

7.1 In our August submission, we noted that it was not possible to submit adequately on the Commission's draft decision,[50] and we also made that point specifically as to this and the next two topics in this cross-submission where there are particular challenges to submitting: costing of re-usable assets; FWA footprint; and copper v fibre/FWA UBA MEA. The Commission has not yet indicated it will provide compliant draft determinations for us to submit upon. Nor has it said what it will do as to the 11 May 2015 submission which we have shown was overlooked by the Commission.

7.2 This gives little choice in the circumstances but to submit in more detail on these topics, albeit hampered by the Commission not addressing in writing many of the submissions. The position is still maintained that compliant draft determinations must be issued and these submissions are therefore inadequate.

7.3 As to costing of re-usable assets we do not address all points in earlier submissions: for example we still rely upon [12]-[14] of our 20 February 2015 submission, to which the Commission is referred, as much of that submission is not dealt with in the July draft decisions.

7.4 There is also the point,[51] not dealt with below (and not dealt with in writing by the Commission), that in any event an HEO would use LFC and Chorus UFB infrastructure (leased as necessary) as that remains after the copper network is notionally removed: there is no logical reason why the HEO would be able to use electricity network poles and yet not be able to use other pre-existing assets such as fibre networks including Chorus' own infrastructure for a parallel network (even if ducting is shared). Similarly as to existing mobile infrastructure owned by MNOs where capacity can be leased. Essentially the counterfactual, relative to when the copper network is removed, includes infrastructure that remains in place.

7.5 The structure of this part of this submission is as follows:

(a) We outline context relevant to how a court would assess whether there is error of law.

(b) We explain why it is submitted that the Vodafone TSO judgment would lead a Court reviewing for error of law to say that ORC for re-usable assets is an error of law.

Context for error of law review by Court

7.6 Relevant context for the Court, when assessing whether there has been error is as follows. This includes, as to all forms of relevant error,*Edwards v Bairstow* considerations. Although the issues primarily lie around error of law outside the *Edwards v Bairstow* category, the Supreme Court case ("Vodafone TSO judgment") demonstrates how far in this area the courts will go into factual issues on error of law appeals.

[50] This is a concern across the board, but see for example, as to re-usable assets, at [10.1] and [10.2].
[51] This is noted in our August submission at [11].

Context Point 1: the Vodafone TSO judgment

7.7 First in terms of context is the Vodafone TSO judgment, dealt with below.

Context Point 2: the Australian Competition Tribunal Telstra TSLRIC decision

7.8 Next is the Australian Competition Tribunal decision relied on by the Supreme Court, in *Application by Telstra* [2010] ACompT 1. This is a decision of substantial significance to a court assessing error of law, from a well-regarded competition law appellate tribunal comprising a Federal Court judge and two distinguished economists.

7.9 A key part of the Commission's conclusions is that ORC sends the correct build/buy signals.[52]

7.10 Australia's circumstances cannot be materially distinguished in this regard. For example, while the Commission relies upon UFB bypass of the copper network, the equivalent in Australia – NBN – did not lead to the Tribunal taking the different approach that the Commission is taking, based on UFB.

7.11 While the Commission concludes that replacement cost (ORC) is justified by the build/buy point, the Tribunal came to the opposite conclusion.

7.12 The Tribunal posed the issue in this way:

> 231. The TSLRIC+ approach seeks to estimate Telstra's ongoing costs of providing the ULLS. But on the face of it Telstra's ongoing costs have nothing to do with those of a hypothetical new entrant to the market providing the declared service, especially as the TEA Model [used to model TSLRIC] is premised on a scorched node approach.
>
> 232. The hypothetical new entrant approach appears to be based in large part on the objective of determining a price that would give a potential new entrant the right signals as to whether to "build or buy", i.e. whether to in fact displace, replace, replicate or bypass (perhaps part of) the existing CAN – provide its own infrastructure to gain access to customers – or to purchase the ULLS from Telstra. (Note that the four terms just mentioned tend to be used interchangeably, although they have different meanings in ordinary English.) But in fact it is inconceivable that any access seeker would now build a copper-based CAN across all Band 2 areas in the manner that the TEA model and Telstra's implementation of TSLRIC+ hypothesise. How can a hypothesis so far from reality be useful?

7.13 That last question – *"How can a hypothesis so far from reality really be useful?"* – applies just as much in the New Zealand context and the FPP process. It is submitted that a Court, on reviewing the draft approach in New Zealand, can readily get to that same question, based on the contextual matters raised in this submission, all of which are material on an error of law appeal.

7.14 After analysis at [233] to [238], to which the Commission is referred, the Tribunal concluded (in passages taking into account (a) the bypassing of the network by

[52] See for example the 2 July UCLL draft determination

– at that point in time – the NBN fibre network and also (b) the Australian concept of LTIE, which is similar to s 18 objectives (so, again, there is a departure by the Tribunal from the Commission's reliance on s 18 to justify using ORC):

> 238. …[The Tribunal] rejects the argument that the ULLS should be priced on the basis of the up-to-date costs of replacing a historical relic while keeping most of its essential design features and merely updating its equipment.
>
> 239. But the Tribunal's difficulty with the submissions presented to it on TSLRIC+ goes deeper than the specifics of the TEA Model. It is troubled by the notion that prices should be set on the basis of hypothetical competition for a market that has natural monopoly characteristics, just as it would be puzzled by a proposal to price access to an electricity distribution network in a way intended to cause users to choose whether or not to overbuild the whole network, replacing it completely. …..
>
> ……The price estimated by the TEA Model is based on the cost of a new entrant starting all over again and building a copper-based CAN from scratch, but using a scorched node approach in which cable routes are constrained to be at best a subset of those laid over many decades in Telstra's legacy access network. Such an approach would not promote competition in the provision of services supplied using the ULLS unless that price reflected Telstra's costs of providing the service (s 152AB(2)(c)).
>
> 241. Such a price would not encourage the economically efficient use of Telstra's network infrastructure unless the price reflects the long-run costs to the community of the resources tied up in, and used to operate, the ULLS (s 152AB(2)(e)). ….Given that the network is in place, but is to be or may be in the future replaced by, or at least compete with, the NBN, the long-run costs to the community of those resources are not those of a new entrant hypothetically building a replacement copper access network within the constrictions permitted by the TEA Model at present.
>
> 242. For the same reason, such a price would not encourage efficient investment by access seekers. It would not reflect the true resource costs to the community of providing the ULLS (i.e. the opportunity cost of not being able to use those resources in a higher value way). And such a price would have no bearing on Telstra's investment decisions, since it does not reflect costs actually faced by Telstra, which has trenches, ducts, etc already in place (s 152AB(2)(e)).
>
> 243. Consequently, the costs of a hypothetical new entrant, as estimated by the TEA Model, do not provide the basis for a price that would promote the LTIE (ss 152AB(2) and 152AH(1)(a)).

Context Point 3: TSO TSLRIC, PSTN FPP TSLRIC and UBA/UCLL TSLRIC

7.15 The next contextual point for the Court, in assessing error of law, is the reality that the TSO modelling throughout has been fully based on TSLRIC.[53] Therefore the modelling on which the Supreme Court required change (as to historic cost and as to using mobile in the MEA), was TSLRIC. The fact that TSLRIC was not expressly referred to in the judgment does not change this fact: the modelling requiring change, and the modelling used throughout, was TSLRIC.

7.16 This is, it is submitted, another major area where the Commission has not addressed submissions in writing. The July 2015 draft decisions read as though there is little connection between the TSO modelling and the UCLL modelling, even though, in this FPP proceeding, the Commission acknowledged in 2014 that the "previous TSLRIC model" it built "was for the TSO".[54] But, in particular, we refer again to the multiple examples of statements by the Commission, showing that the TSO modelling is TSLRIC.

7.17 It is submitted that it is especially concerning that the Commission, in various manifestations over time such as "reasonable investor expectations", "predictability", "conventional" implementation of TSLRIC continues to say that ORC achieves those objectives, when what is clearly known is that the TSLRIC modelling on re-usable assets for TSO was required by the Supreme Court to be at historic cost, and this FPP procedure is a directly following-on TSLRIC exercise (and thus historic cost is the predictable and conventional option, based on precedent).

7.18 This is the more so when, in this FPP proceedings, the Commission has expressly continued the TSLRIC path consistently adopted by the Commission, starting with TSO, then for the PSTN FPP (which relied upon the TSO TSLRIC modelling). The Commission builds from and follows the earlier TSLRIC modelling procedures.

7.19 In our 20 February 2015 submission, we outlined multiple quotes, in tabular form, from Commission documents that shows that this is what happened.[55] But they are not dealt with in the July draft decisions.

7.20 Here are some examples from that list, of statements by the Commission, in chronological order. First, what the Commission says about TSLRIC in 2002 (since then the Commission's approach to TSO was TSLRIC:[56]

> Given that the measurement of the net cost of the TSO is based on modelling different physical parts of a telecommunications network, this suggests that TSO assets be valued on a consistent basis with the TSLRIC modelling. If, for example, the forward-looking cost of a switch were valued in the TSLRIC exercise on the basis of its replacement cost, it would seem logical to value the switching components of the TSO cost on the same basis.

[53] TSLRIC as opposed to the TSLRIC+ currently being modelled, but as we explain at [13.10] in our 20 February 2015 submission that makes no material difference

[54] Commerce Commission draft pricing determination 2 December 2014 at [94], quoted in our 20 February 2015 submission at [13.11].

[55] The following quotes are [13.13] of that submission.

[56] Commerce Commission, TSO Discussion Paper and Practice Note - Implementation Issues Paper, 19 April 2002, para [184] at: http://comcom.govt.nz/dmsdocument/8989.

7.21 Then, in order to confirm that the Commission's PSTN TSLRIC FPP process built from the TSO TSLRIC approach, here's an example from the 2005 draft FPP determination for PSTN:[57]

> In reaching its [PSTN FPP draft] determination, the Commission considered two TSLRIC models:
>
> • the model developed by Telecom ('Telecom Model'); and
>
> • the model developed for the Commission by CostQuest Associates Inc ('Commission Model').
>
> "Both models were based on the earlier CostProNZ model which was developed for the Commission by CostQuest to calculate core network costs for the TSO determination.
>
> …
>
> CostQuest developed the Commission Model … This model includes reports to calculate both the TSLRIC cost of interconnection services and relevant core network costs which could be used for future TSO determinations.

7.22 Use of TSLRIC continued of course beyond settlement of that FPP before a final decision was made.

7.23 Fast forward to 2014 and this FPP process, which follows the same continuous path as to use of TSLRIC through TSO, PSTN FPP and now the UCLL and UBA FPP. The Commissioners say this in the December 2014 draft FPP decisions:[58]

> In order to assist us with determining our approach to TSLRIC, we have closely considered the previous TSLRIC cost model we built (for the TSO).

7.24 And this too in those decisions:[59]

> To adopt a more predictable approach to implementing TSLRIC, our starting point has been to consider our previous approach to TSLRIC when modelling the TSO.

7.25 So, what we have is an FPP TSLRIC process that builds on the shoulders of earlier TSLRIC processes, albeit evolving over time as would be expected. The Commission even points to that evolution in order to "adopt a more predictable approach".

7.26 But missing, without any explanation as to the history set out above,[60] is a key part of the "previous approach to TSLRIC when modelling the TSO". The Supreme Court had directed the Commission that it had erred by using ORC for

[57] Commerce Commission, Draft Determination on the Application for Pricing Review for Designated Interconnection Services, 11 April 2005, paragraphs 113 to 116 at: http://www.comcom.govt.nz/dmsdocument/4371.
[58] Commerce Commission, Draft pricing review determination for Chorus' unbundled bitstream access service, 2 December 2014, paragraph 94.
[59] Commerce Commission, Draft pricing review determination for Chorus' unbundled bitstream access service, 2 December 2014, paragraph 132.
[60] All of which, plus more, was in our 20 February submission

re-usable assets. Right from 2002, the TSLRIC modelling should have been historic cost (or some other cost other than ORC).

7.27 The Commission in draft proposes to do the unpredictable, to do what is not "conventional". It would ignore what the Supreme Court has said in relation to this line of TSLRIC modelling. It is as though the decision does not exist and, instead, the Commission will stick with its modelling approach – ORC – which the Court has said is wrong.

7.28 Alone, this appears, it is submitted, to be an error of law. The current circumstance and the circumstance before the Supreme Court is not materially distinguishable for there is a strong common theme as to the handling of TSLRIC. In the context of the other points we have raised (eg the outlier nature of the proposed price (by a substantial margin) and the observations from Australia), the position becomes even clearer in terms of error of law review by a Court, it is submitted.

Context Point 4: the Commission's expert, Professor Vogelsang

7.29 The Commission has not explained away what its own external adviser on the approach to TSLRIC, upon whom substantial reliance is placed, says about the proposed approach, when it is firmly at odds with the Commission's approach. Yet Professor Vogelsang's opinion is consistent with that of the Australian Competition Tribunal, noted above.

7.30 We outline some of what Professor Vogelsang has had to say (bold added):[61]

> "**the TSLRIC method currently proposed by the NZCC is likely to be substantially more than needed by Chorus for covering the cost of is copper access network**. Thus, the copper access network is likely to remain **highly profitable**"[62] and **"even if the Commission were to reverse its stand on the re-use of civil works would Chorus be [sic] able to generate substantial profits from its UCLL and UBA offerings".**[63]
>
> "Rather than starting from scratch the re-use of those civil works facilities for the new set of cables is usually the most efficient way to go forward. **It also reduces the probability that the regulated firm is over-collecting**"[64]
>
> **"a historic cost approach is generally … more predictable than a replacement cost approach"**.[65]
>
> "A deviation from the classical approach could jeopardize this predictability if the expectation was that the NZCC would not deviate. **It**

[61] These have all appeared in earlier Wigley submissions.
[62] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, para [24].
[63] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, para [118].
[64] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, para [12].
[65] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, para [17].

> **could also reemphasize predictability if the expectation was that the NZCC would follow international trends".**[66]

7.31 As to that last point, there is to be deviation from what the Supreme Court said about ORC v historic cost (and also deviation from the EU position).

Context Point 5: regulation of other dominant suppliers

7.32 Valuing re-usable telecommunications assets at replacement cost is an outlier, with the Commission having decided to value such assets in other sectors at historic cost. See for example [12.10] to [12.15] of our 20 February 2015 submission. Relative to the closely related TSO, it would be an outlier, relative to the Supreme Court decision confirming historic cost should have been used over the years.

Context Point 6: the international comparison

7.33 It is submitted that WIK has, simply and clearly, and in a manner that would be considered by the Court an error of law review, pointed out the errors in TERA's critique of the data produced by Telecom. That points, consistently with the other evidence above, to the prices including as to the major component – the cost of re-usable assets – being well outside what international benchmarks indicate should the case for New Zealand conditions.

Vodafone TSO judgment in the Supreme Court

7.34 It will be apparent from the above points, that TSO is integrally part of the use by the Commission of TSLRIC, as it evolved over time. TSO started the Commission's TSO work. The PSTN FPP picked up the TSO work on TSLRIC.

7.35 And this FPP review built upon the TSO TSLRIC work. It is difficult to understand why these two observations by the UBA and UCLL FPP Commissioners would permit a suggestion delineating TSO from this FPP matter:

> In order to assist us with determining our approach to TSLRIC, we have closely considered the previous TSLRIC cost model we built (for the TSO). [67]

> To adopt a more predictable approach to implementing TSLRIC, our starting point has been to consider our previous approach to TSLRIC when modelling the TSO. [68]

7.36 This is important context that the court on an error of law review will take into account and it is difficult to see the court doing other than holding that the TSO Vodafone judgment is so material that it constrains the Commission from using ORC on re-usable assets. The predictable approach is historic cost. The classic approach is historic cost. The orthodox approach is historic cost. It

[66] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, para [29].
[67] Commerce Commission, Draft pricing review determination for Chorus' unbundled bitstream access service, 2 December 2014, paragraph 94.
[68] Commerce Commission, Draft pricing review determination for Chorus' unbundled bitstream access service, 2 December 2014, paragraph 132.

matters not that there are some differences in the legislation. That is not a reason to distinguish.

7.37 It is also significant that the Supreme Court couched its judgment in terms of precedents, statute and regulation from other industries and other countries (Australia as to telecommunications and as to energy, and the US as to telecommunications.

7.38 This indicates a broader application of the approach than just for TSO.

7.39 In its draft UCLL decision, the Commission has, in our view correctly, accepted that different forms of valuation are possible[69] and that it is to choose which to apply. In doing so, it must remain within legally available confines.

Section 18

7.40 Finally, the choice between re-usable asset valuation involves s 18 considerations. If the choice is not for the lowest cost option, choice of the higher cost must be justified under s 18 and on a quantified basis so far as possible. For example the views at [1234] of the draft UCLL decision would need to be analysed and quantified from the perspective of the end user and LTBEU. For another example, we have outlined above why the build buy choice is no longer material (or material, in the same way). If however the Commission intends to pursue the point, it is legally required to quantitatively analyse the position.

8. FWA

8.1 First, we have submitted that the footprint for UCLL is limited to the DSL-capable footprint that can realistically be provided from each node (exchange or cabinets) based on the details and reasons we have provided in earlier submissions. Contrary to its statutory obligation, the Commission has not dealt with this in writing. Should the footprint be limited, the FWA footprint problem would reduce markedly.

8.2 Chorus submits that the MEA can include no FWA as layer 1 functionality (reflecting UCLL) is not possible. The Commission limits the FWA footprint to a small footprint of lines based on current RBI boundaries, which of itself is problematic as the choice is made based on the actual not hypothetical network configuration (which appears to be contrary to the statute and the TSLRIC framework). Those limits by the Commission reflect the same concerns around FWA not having Layer 1 capability.

8.3 Before developing this further we observe that FWA is capable of providing a better service to those that would otherwise be layer 1 customers, just as the service over a fibre MEA is better than the service over copper. The FWA service is better as it includes Layer 2. An HEO would in fact supply FWA to that otherwise Layer 1 customer. To reduce the FWA footprint to less than what an HEO would do, just to enable Layer 1 and 2 unbundling, simply would not happen. In short, at least Layer 1 can be provided even though it happens to involve supplying Layer 2 as well. The cost of that hypothetical FWA service can be established.

8.4 In the actual world of an HEO, building a new network where the copper network has been removed, it will clearly use FWA instead of fibre over a much bigger

[69] For example UCLL draft decision 2 July 2015 at [1205] and [1218] and [1221]

footprint than is proposed by the Commission, as the experts have noted. The cost of the Commission's modelled network is substantially greater than the cost of what the HEO would actually install.

8.5 All that difference comes about for the simple reason that FWA does not split into Layer 1 and Layer 2. In terms of economics and s 18, that does not provide a particularly rational reason for hiking the price significantly higher.

8.6 TSLRIC is a means to an end: to get the efficient price in a notional competitive world. Applying for example, the Australian Competition Tribunal's decision noted above, the build v buy explanation no longer is a valid reason as to setting price. The higher prices are not justified for that reason whether due to choosing ORC not historic cost for re-usable assets, whether choosing the FWA footprint, whether choosing the fibre or copper MEA for UBA, or any of the other multiple choices where s 18 applies. To take the high side will distort, without benefit to end users as has been so well explained by the Australian Competition Tribunal.

8.7 The TSLRIC tool, with all its flexibility to get the right outcome, given there is little clear direction in the statement, is just a tool. It should be structured in such a way that it achieves the right results: forcing it to have a smaller FWA footprint in the MEA than an actual HEO would install, does not fulfil the statutory objectives including s 18.

8.8 As to choice of MEA, the legislation (particularly the definition of TSLRIC) provides little guidance. There is not even mention of components such as MEAs and HEOs.

8.9 Relevant is s 6 of the interpretation Act 1999:

> An enactment applies to circumstances as they arise.

8.10 Generally, the Commission's drafts have pushed for, in one way or another, an interpretation and an approach which is founded on what happened some time ago (using over time words such as orthodox, predictable, etc). But the law is clear: the Act addresses the current circumstances and it is wrong to look back in that way.[70]

8.11 Choices like a smaller FWA footprint for example inflates the price beyond what is appropriate in current circumstances, contrary to the objective of s 18 and of TSLRIC, applied to current circumstances.

8.12 So, a solution must be found, and that is possible given the ability of the Commission to do so, guided by s 18.

8.13 If, as is submitted must happen, the FWA footprint is modelled on the basis of what an HEO would install assuming no copper network, a way to notionally price UCLL and UBA can and must be found. It is no answer in our submission, to say this is too hard and therefore there should be no or limited FWA. The Commission for example can readily create a formula, utilising Layer 1 and Layer 2 splits over the non-FWA network. This whole exercise after all is hypothetical. If the Commission does not take this path it will inflate the correctly payable prices.

[70] Unless there is strong justification and there is not here.

8.14 Essentially, the Commission already acknowledges that the MEA and its treatment can involve a level of abstraction away from the in situ service (see eg the James Every-Palmer opinion): to achieve the right s 18 outcomes, such an approach can apply here

8.15 In other respects, we support Spark's 13 August 2015 submission as to FWA, at [149]-[176].

9. Uplift UBA Copper v Fibre MEA

Introduction

9.1 In this section when referring to the UBA MEA we are referring to the MEA for the uplift.

9.2 After submissions showed that the Commission had incorrectly concluded it was legally limited to a copper MEA for the UBA uplift, the Commission in the July draft retained the copper UBA MEA, based on briefly stated reasoning.

9.3 There is no known other choice of MEA by any other regulator internationally that splits the layer 1 and layer 2 MEAs in this way. Not surprisingly, it is submitted. It is submitted that a court on error of law review would regard that as decidedly unusual and not a common-sense approach, and that any justification to depart from a normal approach would need to be strongly made out.

9.4 Part of such a common sense approach is this: all RSPs that are submitting oppose using a copper UBA MEA. That includes the largest unbundler (CallPlus),[71] another large unbundler (Vodafone) and the party that has most to gain from pricing that is favourable to unbundling (Spark). The justification used by the Commission to justify the copper UBA MEA is that a greater margin at copper prices incentivises unbundling. But no submitting RSP wants this and unbundling by others has been (and will be) minimal if not nil. This is also the clearest possible evidence that the Commission's assumptions around incentivising unbundling are incorrect, with the consequence that the focus of the analysis, end users, end up paying more for no countervailing benefit.

Fibre UBA MEA costs less than copper UBA MEA

9.5 Without providing any data and calculations, the Commission states that the UBA cost would be around the same whether there is a fibre MEA or a copper MEA.

9.6 That proposition could not be tested as the calculation was not provided. However, that lighting fibre is substantially less expensive than layer 2 copper should be so clear that it "goes without saying" (the additional components in both scenarios to the first data switch do not alter this). We have already submitted for example the TERA statement that lighting fibre is in the order of 10% of the cost of the total layer 1/2 stack. Our clients are confident the appropriate analysis will show a substantial difference in cost: that is assumed in this submission

What is at stake?

9.7 It is expected that the UBA price based on a fibre MEA will be several dollars less than the MEA based on copper. This is a major call by the Commission on

[71] CallPlus only seeks a reduced UCLL price for unbundling purposes, not, as the Commission in effect is doing here, by an increase in the UBA uplift.

this modelling. For every $1 the price goes up or down the impact on consumers is in the order of $100 M.[72]

9.8 Such figures also demonstrate that the light approach to analysis and lack of empirical assessment is well short of what is appropriate, and what is required in terms of quantified analysis by the law, as we have submitted upon on numerous occasions including our August submissions. While the Chapter 4 analysis in each August draft decision, as referred to below, takes a more detailed approach, they too are short of the legally required quantified analysis, as we have submitted previously including in August.

What the draft decisions say about relativity and promotion of unbundling

9.9 At one point, the Commission states:[73]

> On relativity, we continue to be of the view that we should be neutral towards the promotion of unbundling.

9.10 And it states in both the UCLL and UBA draft decisions:[74]

> By way of summary of our discussion of the relativity consideration in Chapter 4, we find that relativity guides us less towards attempting to promote unbundling, and more towards the efficiency aspects of the section 18 purpose statement. We consider that we should be neutral towards the promotion of unbundling, and allow for unbundling to occur to the extent that it is efficient.

9.11 The Commission comes to that conclusion in over 30 combined pages of analysis in Chapter 4 of each decision dealing with the uplift question generally and feeding those conclusions into the compulsory relativity question.

What the UBA draft decision says about copper v fibre MEA

9.12 This is in a separate short section of the UBA draft decision (Attachment B). The following is the conclusion although there is little in the 6 pages on this topic which provides reasons for this beyond what is stated:

> 747. We consider that a MEA for the UBA service that presupposes an underlying copper access network will likely better allow for competition through unbundling where it is efficient. This is because access seeker decisions regarding unbundling are made in respect of the existing copper access network. Therefore, in our view a MEA for the UBA service that utilises an underlying copper access network better aligns efficient build/buy decisions with those made in the real world, compared to the case with the UBA network being built over a fibre access network.
>
> 748. Accordingly, on balance, our view is that section 18, and the requirement to consider relativity between the UCLL and UBA services (as previously explained in Chapter 1 and Chapter 4), lead us to prefer

[72] The calculation of 1.8m * 5 years (60 months) equates to approximately NPV $100m
The NPV $100m corresponds also with the Commerce Commission WACC Uplift spreadsheet - it takes into account decline in copper demand and interest (which basically offset each other).
Not included is the impacts if the Telco Review option is accepted of using the TSLRIC RAB as the opening RAB for post 2020 regulation
[73] UBA draft decision 2 July 2015 at [411]
[74] At [259]

a MEA for the UBA increment that utilises a copper-based access network. Therefore, we have modelled the MEA for the UBA additional costs component based on a copper access network.

Conclusions cannot be reconciled

9.13 Those conclusions, with little analysis in support, cannot be reconciled with the first passages quoted above, that the Commission is "neutral towards the promotion of unbundling". They are 100% opposed to each other, where the first has much fuller treatment and analysis than the second.

An aside, the "central estimate" is not a "central estimate"

9.14 Throughout chapter 4 in each July 2015 draft decision, the Commission continues to describe its conclusions up that point as "central estimates" without s 18 adjustment. Our clients, Vodafone and Spark have submitted on that in the past, saying that often they are not and have been moved North via s 18. In this example, it is readily apparent that s 18 has been used to choose one option (the more costly) over another. That is exactly what is stated. The same occurs elsewhere in the draft decisions, so that "central estimates" are not in fact central estimates. The $ impact of the choice of MEA enters the final round as though it is a central estimate when plainly it is not.

Approach to choice of MEA

9.15 We won't repeat the sources for the submissions below, made multiple times, but they also largely align with the Commission's approach.

(a) The Commission is seeking the most efficient price, by reference to the cost of the network installed by the HEO.

(b) The network chosen notionally by the HEO is to be the one with the most efficient (least cost) cost. That chosen network is the MEA.

(c) The Commission, where necessary, compares the cost of candidate MEA to choose the least cost one

(d) The thrust of Chapter 4 in each July decision is that the Commission can adjust under s 18, within a plausible range, given the uncertainties of TSLRIC modelling.

9.16 On our assumption that the cost of the fibre MEA is significantly less than the cost of the copper MEA, the choice thus far would be a fibre MEA.

9.17 The Commission can (indeed must) then consider relativity. However, still dominating the position is the objective of achieving the efficient price (which has nothing to do with, for example, encouraging unbundling, save to the extent that the efficient price of itself does just that). Thus any room for movement away from that efficient price is within a limited scope.

9.18 We note in passing that the most important submission by our clients in regard to relativity is in the 11 May submission that was overlooked by the Commission and its experts.

9.19 Such movement away from the efficient price must be carefully justified. It must be justified by way of careful and, so far as possible, quantified analysis, in a

manner similar too the Oxera approach (although there are reservations about that too). That is legally required for the reasons we have submitted.

9.20 Such adjustment (eg choosing the fibre MEA instead of the copper MEA by way of s 18 relativity considerations) must be undertaken from the perspective of the end-user because the sole consideration under s 18 is LTBEU, as developed in s 18 (2) and (2A).

9.21 What has happened here is that the Commission has truncated several steps of analysis into essentially a few sentences where the analysis is interwoven.

9.22 Thus:

(a) The Commission has hardly at all addressed the benefits and detriments of a higher UBA price via a copper MEA by asking itself what the impacts on end-users are: does that promote competition in the LTBEU? For example, the benefits from unbundling for end users must be expressly analysed.

(b) They must also be analysed in the round. For example:

(i) There is no mention of detriments (eg higher retail prices caused by a higher UBA price (that is, the all up price).

(ii) The benefits of unbundling in terms of greater competition are not assessed and quantified (or reviewed qualitatively if that is the only option) in what is really only a few lines of analysis;

(iii) The impact on migration to fibre is not quantified (or assessed qualitatively if that is the only option).

(iv) All RSPs are saying they do not want the fibre MEA, implying they do not see investment in unbundling as the Commission sees it. Put another way, the Commission has actual evidence from market behaviour that is directly contrary to its assumptions around incentives created by higher UBA uplift pricing. The Commission would need to explain why it dismisses that strong evidence given consumers will pay more for no countervailing benefit.

9.23 A quantitative analysis must by law be undertaken (with qualitative elements if necessary although we have submitted,. Including in the 11 May submission, that dynamic efficiency elements can be quantified, as the Vertigan report shows).

9.24 We add to that, that adjusting relativity by choosing a copper MEA instead of a fibre MEA (assuming the fibre MEA is the least cost MEA) is unlawful as it is too blunt an instrument to achieve s 18 relativity objectives. It is irrelevant. The correct approach is to first choose the least –cost MEA, and then make relativity adjustments under s 18 on the cost of that MEA.

9.25 We also note that the approach in the passage to build/buy decisions is not correct (the right build buy choice should be based on the fibre network as the MEA and indeed that is a key purpose of TSLRIC, rather than the build buy decision based on legacy networks). In any event it must be carefully analysed with net effects demonstrated by quantification. That build buy description by

the Commission does not take account either of the essential end-user perspective.

9.26 Additionally there has been no analysis of duplicated costs due to different types of networks.

9.27 We submit that a Court on error of law appeal would conclude that, if this position remains in the final report, there is error of law.

9.28 In solving for this, it is submitted that the approach remains that a step by step process should be undertaken instead of a largely one step process.

Our other submissions

9.29 We do not repeat our earlier submissions including those on 20 February, 11 May and August but we continue to put them forward as submissions.

Fibre MEA only option

9.30 In practice, there might have been a rare occasion when the UCLL price has been determined on a copper MEA, and the UBA uplift is to go to FPP separately where choice of MEA for UBA crops up (copper or fibre). Now however, the UCLL MEA is very likely to be fibre (but even if it was copper, our observations that follow would apply).

9.31 We started this section by noting that a split MEA contravenes practicality and general common sense approach (and departure from the same MEA must be heavily justified).

9.32 Whatever the relative cost of the copper and the fibre/FWA UBA MEA, we submit that only a fibre/FWA UBA MEA is legally available.

9.33 For example, in dealing with an IPP issue, the Court of Appeal in Chorus v Commerce Commission observed:

> It is also reasonable to assume, on the basis of the principle of statutory interpretation that the provisions of a statute are likely to be internally consistent,[75] that the statutory definition of the UBA price reflects the requirements of s 18, including in particular subs (2A) which was enacted at the same time. In other words, the mandatory requirement for the Commission to carry out the "benchmarking" exercise for the IPP by reference to appropriate "comparable countries" is itself designed to implement the statutory purpose, not to contradict or undermine it.

9.34 In our submission, it would not be "internally consistent", as between inter-related services, particularly one (UBA all up service of which the UBA uplift is part) which has the other (UCLL) as an essential component, to have split MEAs.

[75] Burrows and Carter, above n **Error! Bookmark not defined.**, at 237–242.

10. Problems with the FPP process

Introduction

10.1 We introduce this topic by a conclusion from the end of our last topic (choice of UBA MEA).

10.2 When the Commission accepted submissions that it was not legally limited to a copper MEA, it stayed with the same conclusion by way of an extraordinary construct, with little reasoning, where the conclusion (and the limited reasoning) was 100% contrary to the more careful and detailed reasoning elsewhere in the same draft decision. That raises a concern as to what and why that happened, and this will be put in context along with other matters.

The Commission states it has a concluded view on cost before consultation starts

10.3 On the day of the release of the 2 July 2015 draft decisions, the Telecommunications Commissioner did an OpEd in NBR called *NZ Broadband – land of the long trenches*.[76] Much was devoted to the TERA analysis showing that the Manhattan graph put forward by Spark did not reflect real conditions in New Zealand, so the draft price was not so out of kilter with international benchmarks. As it happens, WIK have produced their analysis disagreeing with TERA (as we note above, convincingly). The key here however is that, when dealing with those Manhattan issues, the Telecommunications Commissioner said in the article:

> "We are confident that our bespoke model for New Zealand accurately represents the costs of our wholesale broadband network."

10.4 In other words, it is being stated that the Commission has a concluded view, before considering submissions on the draft issued on that day,that the model "accurately represents the costs of our wholesale broadband network". That conclusion is as to the overwhelmingly main element in the FPP process

10.5 That has at least the appearance of pre-determination by the Commission of the bulk of its task. But, in its exact words, it is pre-determination.

10.6 In isolation this might be of less concern (although even then it is of considerable concern). However there is the context outlined below including modelling that produces, despite considerable change in parameters and inputs, pricing in July that is similar to the pricing in December last year.

Prices between December and July are largely the same

10.7 The July 2015 revised draft price for UCLL and UBA combined was $38.43, 4 cents higher than the December 2014 revised draft price for UCLL and UBA combined of $38.39.

10.8 There has been a considerable amount of modelling changes in the intervening period, as reflected in the Commission's documentation and expert submissions from WIK and Network Strategies. It is statistically highly unlikely that such

[76] http://www.nbr.co.nz/article/nz-broadband-land-long-trenches-p-174995

substantive changes to modelling would result in the same or similar outcomes. That raises a question as to what is happening here with most (and probably all) parties now strongly expecting that:

(a) there is little they can do to move the prices in the final FPP; that give or take a cent or, these draft prices will be the final price, whatever the strength of arguments against the draft position; and

(b) where a party demonstrates that a ground is not sustainable, some other ground will be put in place to support retention of the status quo.

10.9 Our clients have submitted on numerous occasions since the start of last year with concerns about issues as to process, as to one ground simply replacing another leaving the initial decision intact,etc and that, for example, the speed and time pressure makes it difficult for the Commission to revisit many of its earlier choices. The combined circumstances in those submissions (which continue to be relied upon but are not repeated here) and these submissions, give the appearance of this happening.

Criteria changes, decision doesn't

10.10 A number of substantive aspects of the modelling approach and assumptions, such as valuing re-usable assets at ORC and the (limited) form of scorched node has been preserved throughout the determination process. The rationale provided for these decisions has changed substantially though. For example, after it was demonstrated that the Commission's ground for having a copper UBA MEA was not supportable, the Commission instead retains the copper UBA MEA on grounds that are briefly stated as noted above, but grounds that are diametrically opposed in over x pages of analysis elsewhere in the draft submissions. Having a copper UBA MEA and a fibre/FWA MEA is, we submit, an extraordinary combination and no other such combination is known of in other jurisdictions.

10.11 A common thread in submissions throughout the determination process is that the Commission has substituted the s 18 purpose for alternative criteria. The Commission's response has not been to revert to s 18, but instead to make shifts to alternative but overlapping criteria, albeit sometimes under the s 18 banner. So "reasonable investor expectations" becomes "predictability" and certainty which then becomes a "conventional" or orthodox approach to TSLRIC, where the Commission considers that a "conventional" approach satisfies "predictability" and "predictability" in turn satisfies "reasonable investor expectations" (even if the latter is no longer an explicit criteria).

10.12 This is illustrated by the Commission's comments in 2014 that "respecting reasonable investor expectations … would help build predictability into regulation",[77] "predictability supports investment"[78] and "an orthodox approach is desirable and fundamental to our construct of predictability"[79]:

> In terms of the distinction between predictability and investor expectations, part of our approach to the application of TSLRIC is to give weight to greater predictability of approach by generally adopting an orthodox TSLRIC approach. We note that

[77] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, 2 December 2014, para [176].
[78] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, 2 December 2014, para [184].
[79] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, 2 December 2014, para [137].

> this promotes predictability without attempting to identify and give weight to reasonable investor expectations as a separate exercise.[80]

10.13 Despite the purported change in criteria, and acknowledgement by the Commission it had "overstated the relevance of predictability"[81] there is no discernible evidence that this purported change impacted on any of the Commission's decisions.

10.14 There is the impression that, as one ground is shown to be incorrect, it is replaced with another ground with the same effect.

10.15 Consistent with these observations, Spark noted in 13 August submissions, in summary:[82]

> Throughout the process, the Commission has adopted specific objectives that are not supported by the Act and used these to determine its key modelling choices. In July 2014 it was "reasonable investor expectations". In December 2014 it was "predictability". At each stage, submitters advised that these were not lawful objectives under our Act. Each time the Commission resiled from them. Despite these significant changes in its guiding objective, the Commission's key modelling choices have not changed through this process.
>
> In this further draft determination, the Commission relies on "conventionality" as the key determinant of its modelling choices. Again, its key modelling decisions have not materially changed. This reliance on conventionality repeats the same error, because conventionality is no more an objective of our Act than investor expectations or predictability were.

For downward change, there are upward changes

10.16 An analysis has been undertaken of the WIK submission of August 2015 and the TERA documentation "Implemented modelling changes" of June 2015 in order to identify the material movements in upside/downside cost adjustments to the Commission's/TERA's model. As a first step we list the material examples below

10.17 Based on observations on the modelling changes, the upward and downward adjustments tend to balance out within each cost and parameter. It also appears that the upward adjustments have resulted in greater reliance on Chorus' input costs (for example, opex, common costs and non-network costs) shifting the modelling further from the efficient costs of an HEO and closer to Chorus' actual costs (there has already been concerns that the modelling was over-reliant on Chorus' actual costs and network configuration).

10.18 This is illustrated in the table below where downward changes and countervailing upwards changes are demonstrated within each block.

	Downward changes	**Upward changes**
Lead-in	(-) Some horizontal trenching lead-in costs were taken out, but not all assets	(+) The number of poles and their height have been increased

[80] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, 2 December 2014, para [187].
[81] Commerce Commission, UCLL draft, 2 July 2015, para [139].
[82] Spark, Further draft pricing review determination for Chorus' UBA and UCLL services, 13 August 2015, paras [10] – [11].

	Downward changes	Upward changes
		(+) Some horizontal lengths appear often to be measured to the wrong end of the road segment and so have been increased
Network/Trenches	(-) MDF and SC coverage areas are now based on a simplified Voronoï's polygons approach instead of actual coverage areas, but still does not follow a cost optimisation approach regarding road lengths (-) The Commission has revised its position and assumed that (only) 5% of underground infrastructure will be shared with utility companies. (-) The MDF areas now, according to the model description, have been delineated in a new and efficient manner	(+) The Commission provided an updated geomarketing database including increased lengths (+) Chain digger technology cannot be selected as the cheapest technology (+) Reinstatement costs have been added to open trench (+) Traffic management costs have been added (+) Reinforcement costs have been added to critical trenches
Ducts	(-) Smaller, cheaper sub-ducts are introduced	(+) Duct prices significantly increased (+) Ducts (and its corresponding trenches) themselves are still too big, not reflecting potential of smaller sub-ducts
FWA	(-) The deployment of FWA in the 700 MHz band (-) Sharing of FWA sites with other network services and network operators (-) The peak throughput for FWA was increased from 16.7 Mbps to 22 Mbps	(+) New general approach of Commission by reducing significantly the scope of FWA
Demand	(-)The gap between dimensioning demand and actual demand has been reduced by treating HFC demand as part of the fixed-line service demand	(+) Now Commission plans to increase the gap due to new Census data (see new consultation due to 02/10/15)
Cables	(-) Surplus decreased	(+) Installation costs significantly increased

	Downward changes	Upward changes
	(-) The cable dimensioning achieved some improvement in the model in aggregating single pairs or strands into one larger cable	
OPEX		(+) The cost saving for Fibre OPEX is set to 40% compared to Copper OPEX in the base case scenario instead of 50%. (+) <issing property charges were captured as highlighted by Chorus (+) An 80% utilisation factor for square meters has been implemented (based on a comment from Analysys Mason) (+) This aims at avoiding over-optimisation as floor space cannot be 100% occupied and future requirements if any need to be anticipated.
Non Network costs, common costs		(+) Doubled

10.19 Based on these adjustments to the input parameters in the Commission's model:

(a) the Commission's/ TERA's upward and downward adjustments tend to balance within cost and parameter blocks;

(b) the downward adjustments focus more on (unavoidable) structural changes, (for example smaller sub ducts, higher FWA peak throughput). Upward adjustments focus more on significant increases of Chorus input price/cost basis (for example OPEX, common and non-network costs). One can infer that the Commission's intention is to counterbalance the downward adjustments with the upward adjustments.

(c) The overall impression is that the Commission chooses defensible items for potential upward adjustments. These adjustments are based on NZ/Chorus specific price/cost inputs, which are hard to test/check for efficiency and only with an NZ focus, in order, it is submitted, to have a "knockout argument" in defence.

Our 11 May 2015 submission (and other submissions)

10.20 Our August submission led with a case study that showed clearly that, in preparing the draft report, and in the reports done by the Commission's experts, our 11 May 2015 report had been totally overlooked. That could be deduced from the evidence referred to in the case study. This is on top of the wider concerns that the Commission has not addressed submissions adequately in

writing. The failure to deal with the above submission raises a question mark as to how and whether other submissions have been handled

10.21 On the issue as to reasons in writing, we have advised our clients that we are confident that the Court on appeal and/or judicial review would agree that not taking that step is in breach with the consequences we have outlined earlier, given the authorities are straightforward and clear. Why this is raised here is the overall context of the issues being addressed in this section of this submission, raising as they do a number of public issues (including specific legislative issues such as this. A picture is emerging more clearly, based on all the circumstances not just one (such as the NBR article) as to what is happening in this process.

10.22 Returning to our 11 May 2015 submission, it is one of the most important of the submissions lodged by our clients. Including as to relativity, CBAs, s 18 uplifts and so on.

10.23 It was hoped that the Commission by now would have taken steps to remedy this error, but it has not done so (just as it has not taken steps to provide reasons in writing on submissions). Thus, in what is submitted to be an unsatisfactory position, it is necessary to submit on substantive matters as outlined above, absent necessary information.

Conclusions

10.24 Taking all circumstances into account, it is submitted that there is, thus far, an appearance that certain requirements of public law (such as pre-determination, bias, and non-compliance with the audi partem alteram rule) and the Act (such as giving reasons in writing on submissions) may not be compliant here. Generally, in public law, appearance is as important as actuality. There is a pattern of evidence emerging so far.

10.25 To be made clear is that such public law breaches are not alleged in this submission (particularly as this would not be done until full analysis). Rather the concerns are outlined, given that a body of evidence is developing prior to further analysis and research, and so that the Commission is aware of those concerns, so that it has an opportunity to take remedial action.

11. TSLRIC prices should not be levelised

11.1 Prior to the current consultation, Chorus had not submitted in writing or objected to RSP preference that the TSLRIC prices not be levelised over the 5 year regulatory period. This was despite opportunity to do so eg as part of the cross-submission on the December draft decisions.

11.2 The only time Chorus had commented on levelisation was at the April conference where they made it clear that they were comfortable with the Commission dropping the proposed levelisation:[83]

> CHAIR: In our draft determination we traced through the way in which capital costs were turned into annual payments and annual payments turned into monthly charges per line, and then in a flash of creativity we decided to levelise those over the course of the five years so it was a constant nominal number thinking that that would be simpler for all

[83] UCLL and UBA Services Final Pricing Principle Conference held on 15-17 April 2015, Transcript, pages 283-4.

> parties and a great relief to everybody. As far as I can make from submissions, nobody likes that option; am I right?
>
> ANNA MOODIE: I think we're okay with that option.
>
> CHAIR: You're ambivalent, you don't mind either way?
>
> ANNA MOODIE: We had a slight preference for constant nominal price, we thought that it provided stability, so.
>
> CHAIR: But no other particular motivation?
>
> ANNA MOODIE: No.
>
> CHAIR: Okay. Anybody else resiling from their lack of interest in the levelising? (Pause). Okay, so we don't need to spend time on that. It's obviously a simple matter to go back to a price that increases according to the increasing cost path that's built into the whole model, the tilting number, so then the price would go up every year by whatever the aggregate effect of all of those little indices was. All right, make sense?

11.3 As a consequence, no party other than Chorus (and brief submissions by Spark[84]) commented on the matter in the submissions on the revised draft – there wasn't any need as consensus had been achieved.

11.4 Chorus has flip-flopped on the matter, and is now arguing it wants a levelised price on the basis of "simplicity", by glossing over the effective concession it made at the conference: on this point it now submits:[85]

> Our preference is for a constant price for the regulatory period. We acknowledge that the general preference expressed at the Commission's Conference by RSPs was for a glide path. But our view is that a single price for the regulatory period has the advantage of simplicity.

11.5 Thus, the only point taken by Chorus is there should be levelising as that has "the advantage of simplicity".

11.6 Chorus has not explained why having to adjust its UCLL and UBA prices once each year, for known prices at the outset, would cause it or others problems and create complexity. If a corner diary can cope with adjusting prices more than once every 5 years Chorus should be able to as well.

11.7 It is also unclear why Chorus might consider having to adjust its prices once a year isn't simple enough, but RSPs should have to cope with the complexity created by backdating.

11.8 In a comparator industry, it should be noted that energy networks operating under Part 4 do not operate under a single levelised price (typically they face CPI-0%).[86] In principle at least, it would be possible for the Commission to make a lower initial starting price adjustment (where the adjustment is downward), at

[84] Spark 13 August 2015 Submissions at [312] –[316].
[85] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 July 2015), 13 August 2015, para [29].
[86] Energy networks face the additional issue, not faced by Chorus that they have to convert the price cap they operate under into a series of prices, and ensure the prices do not result in breach of the price cap.

the beginning of the regulatory period, and then set prices at CPI-CPI rather than CPI-0%.

11.9 As the only point raised by Chorus is the simplicity argument, we submit that it is not necessary for the Commission to go into more detail than it already has in the draft determination, beyond dealing briefly with the simplicity point.

11.10 However, if necessary to go further, the issue is well summarised by Spark in its 13 August 2015 submissions[87] and in the CallPlus, WIK and Spark submissions on the December 2014 draft determination documents. Those submissions are relied upon.

12. Backdating

12.1 The rest of this submission deals with backdating, in the following order:

(a) Overview: no requirement to backdate due to 2006 Court of Appeal judgment;

(b) The Commission's external legal advice as to obiter;

(c) Our submissions as to obiter;

(d) The current state of play;

(e) The Commission's submissions for the 2006 Court of Appeal hearing;

(f) The RSP letter to the Minister in 2013;

(g) The 2014 UCLFS backdating decision;

(h) The 2015 retail price increases;

(i) The lack of commencement date in the FPP process;

13. No requirement to backdate due to 2006 Court of Appeal judgment

Overview

13.1 Chorus submits the 2006 Court of Appeal judgment requires that the Commission has no option but to backdate for the full period, as the judgment must be followed by the Commission.[88] Therefore, submits Chorus, *"the Commission is not required or permitted to carry out some "balancing act" to determine the most suitable operative date for the review determination."*[89]

13.2 However, the part of the judgment that deals with backdating to the IPP date is obiter and not binding on lower courts or the Commission. The July draft decisions rely on the Commission's external legal advice that the relevant parts of the judgment are obiter. We submitted on this, and Chorus did not take issue with those submissions, either in cross submission or thereafter. Nor did Chorus take issue with the Commission's external adviser that the relevant part of the judgment is obiter.

[87] At [312]-[316].
[88] Chorus 13 August 2015 Submission at [287.1]- [287,6] [289], [318]-[321]
[89] Chorus 13 August 2015 Submission at [287.6]

13.3 These circumstances are a good example of why the obiter doctrine is valuable.

13.4 In any event the circumstances are now different such that the 2006 judgment is not binding and, and, anyway, its relevance is limited.

Our submission assumes backdating is possible, but that is not our primary submission

13.5 Our primary submission is that backdating is not available, for the reasons in our February and our August backdating submissions. The Commission, contrary to what it must do, did not engage with those submissions.[90]

13.6 Also the point arising out of the General Terms remains (as submitted upon by us in the August backdating submissions).

The Commission's external legal advice as to obiter

13.7 In explaining why the Commission has discretion over whether to backdate, in a passage adopted by all three Commissioners, the Commission relied, in the July 2015 draft UCLL decision,[91] upon the legal advice it obtained from Dr Every-Palmer in April 2014.

13.8 That advice correctly confirmed that, in relation to the issue before the Commission, the Court of Appeal's observations are obiter:[92]

> In that [2006] case, Telecom sought a declaration that the FPP price in a PRD could not commence earlier than the date the review determination was made. The High Court declined to grant the declaration and the Court of Appeal dismissed Telecom's appeal.
>
> 7. Since neither of the other two parties (the Commission and TelstraClear) counterclaimed for its own declaration, I regard both Courts' comments about the correct interpretation to be *obiter*. That is, the Courts disagreed with Telecom, but made no formal ruling as to the correct interpretation.

Our submissions on obiter

13.9 In summary, we approached the obiter question in this way:[93]

(a) Telecom's application only sought a declaration that there could be no backdating prior to the PRD date. There was no application as to how far back before the PRD date must or could the Commission backdate;

(b) Therefore, the Court of Appeal's views on backdating to the IPP date are obiter. But the short point is that Dr Every-Palmer must be correct and it is not surprising that Chorus has not so engaged.

13.10 Chorus has not engaged with our 20 February 2015 submissions that the Court of Appeal judgment, insofar as it is relevant to this FPP, is obiter. That includes in its 20 March 2015 cross submissions in reply to those submissions.

---

[90] Save to the extent that the point at [850.1] can be seen as commenting on our submission. However, the Commission is not bound by the 2006 decisions for the reasons outlined by us, by Spark and by Vodafone and the Commission should review the position afresh.

[91] At [849].

[93] In our 20 February 2015 backdating submission.

13.11 That it has not done so is understandable as this seems to be a straightforward application of the obiter doctrine. On that basis, Chorus cannot contend that the Commission is bound to backdate to the IPP date.[94]

13.12 Addressing this in more detail, as we said in the summary to our 20 February 2015 backdating submission:[95]

> However, that statement [that there be backdating to the date of the IPP] does not bind the Commission…. That is because:
>
> (a) That was not an issue which the Court of Appeal was asked to decide. It was only materially asked to decide whether the new pricing came into effect on the FPP determination date, and no more. The actual date of the new prices commencing (other than the FPP determination date) was not a matter before the court.
>
> (b) This is at the heart of the importance of the obiter doctrine, a doctrine that still applies strongly even though, in some areas, some lawyers regard it as somewhat technical. It would be wrong, and lead to poor outcomes, for subsequent events and subsequent parties (who are different) to be bound by an appellate statement based on issues that simply were not being decided by the appellate court. That would involve taking a statement in a case about a different matter out of context, where that issue has not been fully considered by the Court.

13.13 And at paras [2.4] and [2.5] of the same submission, we outlined why it would be incorrect legally to simply apply the statement that there is to be backdating to the IPP date:

> 2.4 That is because the judgment is, materially, solely dealing with a declaration sought by Telecom, declaring that the FPP price cannot take effect prior to the date of the FPP determination.
>
> 2.5 Although it is apparent that the Court of Appeal considered the issue of backdating to the IPP inception dates, that was not a matter for decision. For example, we cannot be sure that the parties made full submissions on broader matters and that the Court gave adequate consideration. The observations below [in the 20 February 2015 submission] indicate otherwise. We identify a number of issues apparently not before the Court, or at least not dealt with by the Court.

13.14 To the same effect is Spark in its 20 April 2015 submissions:

> 284. Chorus' claims that there is superior court precedent requiring that a FPP price review determination be backdated to the commencement of the regulatory period from which the IPP determination took effect. But, as we have previously pointed out, and consistent with the legal opinion of Dr Every-Palmer, that decision does not constitute a binding precedent for this PRD for a standard terms determination. In their response to Dr Every-Palmer's opinion, even Chorus' legal advisers, Chapman Tripp, avoided directly suggesting that the Telecom decision constitutes binding precedent on the Commission in this case. Their view was rather that it was not about whether the Court of Appeal view on backdating was obiter or ratio to this PRD, but what was relevant

[94] Or December 2014 in the case of UBA.
[95] Wigley & Company 20 February 2015 submission at [1.2].

was the fact that a superior court in New Zealand had expressed a view on backdating. While we acknowledge the relevance of the court's views all parties seem prepared to acknowledge the obiter nature of the court's comments in this case mean that the Commission retains a discretion.

13.15 In summary, Chorus is now precluded from arguing that the Court of Appeal judgment is binding as to backdating to the IPP date, having not submitted earlier as against the Commission's external legal advice and as against our submissions and those of Spark. In any event, the Court's observation are clearly obiter and are not binding on the Commission.

The current state of play

13.16 What emerges from the Commission's July 2015 draft decisions, our submissions, and the submissions of Vodafone, Spark, and their experts, is that there is a large number of issues and a great deal of evidence and legal analysis that was not before the Court in 2006. Much of that is listed in our 20 February 2015 submission on backdating, a submission on which we continue to place strong reliance (which also is a submission upon which Chorus did not cross-submit as to any of the issues in its 20 March 2015 cross submission or thereafter).[96]

13.17 We submitted then that the Court of Appeal has made errors in its judgment, most notably by assuming that the most efficient price is enough of itself to fulfil the efficiencies objectives in s18 (when the Court of Appeal has, it is submitted, conflated efficiency in the sense of lowest hypothetical cost, with the broader dynamic and static efficiencies (of which the efficient/lowest cost network and price is only one factor)). We deal with these submitted errors in the same 20 February 2015 submission on backdating, as well as in our August submission on backdating.[97]

13.18 The Commission can and should address these errors, take account of the new information and new circumstances, and adopt its own approach, unconstrained by the Court of Appeal judgment as it is not binding on the Commission. It can start afresh, provided it complies with the overall legal framework.

Rationale for the obiter rule

13.19 As it happens, the 2006 judgment, as to its handling of a requirement to backdate to the IPP date, is a very good illustration of the rationale for the obiter rule. More detailed analysis of material not before the Court of Appeal outside the issue to be determined by the court produces a quite different set of considerations and outcomes. The obiter doctrine is there for a reason and it is no mere technicality.

14. The Commission's submissions for the 2006 Court of Appeal hearing

14.1 Chorus make much of the Commission's 2006 submissions to the Court of Appeal, on the basis that they support their own contentions (and clearly they do in a number of respects).[98]

[96] Which is separate from the main submission.
[97] Which is separate from the main submission.
[98] Chorus 13 August 2015 submissions

14.2 Correctly, Chorus do not seek to accord to the submissions any legally binding effect. Noted in this regard is that the Commission had not made any statutory decision as to backdating and was not doing so in relation to its involvement with this Court application for a declaration. The whole point of the application for a declaration was to have a declaration (precluding backdating) before the Commission when it made its PRD decision, the Court having by then declared what the legal position was. In fact, no such declaration was made by the Court, and therefore no declaration would have been before the Commission on the PRD, if that point had been reached. The matter in the end did not reach that point.

14.3 The status of the Commission when making its submissions to the Court of Appeal was, instead, as the first named respondent to the proceedings brought by Telecom. It was a litigant making submissions in court, opposing an application by Telecom, not a decision maker at this point. A litigant's submissions, albeit those of the regulator, must be considered in that context. They are taking a position.

14.4 In any event, just like the obiter observations by the Court of Appeal, so to should the Commission's submissions be discounted when they also are directed to matters beyond the subject at hand: the declaration sought by Telecom, which raised no question at all as to backdating to the IPP date.

14.5 We now know and understand a great deal more about the issues and facts involved here than was known and considered back in the 2006 proceedings. Some of the facts have materially changed since 2006. All this is apparent from the July 2015 draft determination itself, including what all of the Commissioners have said, and from the submissions including experts' reports in this FPP matter.

14.6 We will not deal with all of the matters Chorus raise on this Commission submission, as they are irrelevant for the reasons above. But, to illustrate the problems with relying on the Commission's submissions, we point to one of the headline quotations from those submissions that Chorus relies upon, right at the start of its Executive Summary on this point:[99]

> "… the Commission, in the context of the statutory regime, [when doing the Pricing Review Determination] performs an analogous role to that which the High Court does on judicial review".

14.7 That is almost exactly what the High Court does not do. Judicial review rarely involves **fact** review (that generally only happens in rare *Wednesbury* circumstances): it involves **process** review. The FPP process leading to the PRD is intensely factual in nature, involving a fresh, detailed and different start on the facts. This simple error, well known to lawyers, implies some real care is needed when considering the Commission's 2006 submissions.

15. Industry letter to Minister in August 2013

15.1 Chorus raise this old history to justify pricing at this level.

15.2 That is irrelevant, and happened at a point in time. Since then, it is clear that the RSPs that are participating in this process have a much better understanding of what is involved and clearly do not agree that pricing at that level is correct. Moreover, a basis for settlement then, involving compromises and avoiding the

[99] Chorus 13 August 2015 submissions at page 10.

risks of an FPP process, is not a basis for assessing the parties' position after the matter did not settle. Proposed compromises involve multiple trade-offs and considerations.

15.3 But of particular significance is that RSP views, and RSP actions on this, are irrelevant. The regulatory regime is based on the position of the end-user. Consumers did not participate in that letter to the Minister. RSPs can pass through higher prices to their consumers (not all, as it since transpired). Their perspective is irrelevant to the perspective of the end-user: an outcome for the RSP, as a passing-through middleman, can be workable for them, yet harmful to consumers.

15.4 Additionally, there are many RSPs beyond those that signed the letter, and they cannot be ignored, despite their smaller sizes.

16. UCLFS backdating in 2014

16.1 Chorus say there should be FPP backdating as the Commission fully backdated the UCLFS charges.

16.2 We continue to submit that there can be no backdating and thus the UCLFS backdating was not permitted by the Act.

16.3 Even if there can be backdating, the UCLFS backdating is different from the FPP position:

(a) The Commission was fixing an administrative error, an error that was obvious to all parties;

(b) The change in the price was clearly known and of relatively small impact;

(c) In any event, UCLFS backdating fits within a different category, for the reasons dot.econ give.

(d) The UCLFS backdating does not lead to the conclusion that FPP must be fully backdated to the IPP date (and December 2014 in the case of UBA).

17. The effect of RSP retail price increases

17.1 Chorus has submitted that:[100]

> RSPs appear to have passed on the price increases to end-users already, such that they have (or have had the opportunity to) provision against lump sum payment already.

17.2 From the FPP submissions prior to Chorus submitting in July 2015, this is clearly incorrect, at least as to Spark, CallPlus and Snap.

17.3 Snap did not change its prices so there is nil pass through for them, as we have submitted.[101] Spark and CallPlus both did not fully pass on the price increases to end-users, either, as they submitted. The deltas between 100% pass-through and actual pass-through to consumers in each instance is in the confidential versions but we can say that it is large in the case of CallPlus.

[100] Chorus 13 August 2015 submissions at [323.2].
[101] Wigley 20 February backdating submission at [4.27].

17.4 First, as to CallPlus, in its 20 February 2015 submission, CallPlus gave the following evidence (which was not contested or submitted upon by Chorus):

> 37. CallPlus Groups re-price in March recovered [ ]CPRI % of the increase in monthly cost (IPP to FPP), averaged over all customers impacted, and [ ]CPRI % for UCLL customers.
>
> 38. However the overall under recovery is larger than this. [The submission then lists additional points]
>
> 39. …**If you factor in the $3.27 increased UBA connection costs on top of the IPP to FPP monthly increase the re-price only recovered [ ]**CPRI **% of the increase.**

Spark, Vodafone and M2 are not the only RSPs

17.5 Additionally, Chorus' submissions read as though the only RSPs involved in and affected by the FPP are Vodafone, Spark and M2. This is the consistent theme throughout. But there is of course a substantial number of other RSPs, of which at least two (Snap and Trustpower), as noted in our August 2015 submission,[102] have not put up their prices following the December 2014 announcement by the Commission. Their shareholders effectively meet 100% of any backdating.

Chorus proposals would breach its non-discrimination obligations

17.6 Chorus proposes that:[103]

> Repayment options that are tailored to the circumstances of RSPs will be offered by Chorus to mitigate any issues that may arise…

17.7 Such differentiated options would have Chorus breaching its non-discrimination obligations. One-size-fits-all is the only approach as we outlined in our August submissions.

18. Act provides no commencement date

18.1 Chorus submit[104] that the absence of a statutory requirement as to the commencement date of the FPP price, while there is a statutory requirement to include the expiry date in the PRD, implies that the PRD date is not (or not necessarily) the commencement date for the new price.

18.2 Chorus has never opposed submissions (from cross submissions to those submissions and thereafter) that, absent a specific commencement date (eg, the new price starts from the IPP date), the default position is that there is no backdating. This was explained in our submissions,[105] based on authority such as *Vodafone v BT and Ofcom*.

19. Efficient price is not the only s 18 factor

19.1 Chorus say that, if there is no backdating, "the Commission would be proceeding on the basis that the s 18 purpose was met for the period over which Chorus was receiving inefficiently low prices for the supply of its services. That cannot sensibly be the case."[106] Chorus state that "It is also wrong to proceed on

[102] At [4.9(c)] and [6.14].
[103] Chorus 13 August 2015 submissions at [33].
[104] Chorus 13 August 2015 submissions at [28.7.5]
[105] Wigley & Company backdating submissions dated 20 February 2015 at [4.15] – [4.20] and [4.34].
[106] Chorus13 August submission at [287.8].

the basis that any decision to backdate the review determination must demonstrably promote competition."[107]

19.2 We agree with all the Commissioners' observation that "The basis of the discretion for setting an earlier start date that the date of the final determination is section 18".[108] As noted above and in earlier submissions, the most efficient price refers to the lowest price incurred by the HEO and that price does not answer all static and dynamic efficiencies that are relevant under s 18. Efficient price feeds into efficiencies analysis but not the other way around nor do they equate. The submissions and experts reports (and the Commission's draft decisions) correctly outline multiple reasons why there should not be backdating: optimally efficient pricing is only one factor.

19.3 Chorus are incorrect to say that the decision to backdate does not need to "demonstrably promote competition". In fact that is exactly what every s 18-based decision must do as that is what the Act states. And Chorus correctly acknowledges that s 18 applies.[109]

20. RSPs are "sophisticated commercial parties"

20.1 It is surprising Chorus continues to maintain that the parties can forecast their exposure and manage risks[110] when there is so much evidence showing that is not possible to do, including for Chorus itself. The delta between WIK estimates and Analysys Mason compellingly shows this, as does Chorus' own complaints about being blindsided by the UBA price. Notably, Chorus have not sought to rebut that evidence and submission. That 3 RSPs increased their prices does not support Chorus in this regard.[111] Those RSPs were simply reacting to very direct and clear information about draft prices and draft indications of backdating. That is far removed from reliable forecasting of FPP prices. Moreover, there is a large number of RSPs of varying sizes, none of which could realistically plan for backdating.

20.2 Chorus cites the 2006 Court of Appeal judgment's observation that market participants could be expected to prudently plan for contingencies.[112] The real world experience and full information available 9 years later shows that is simply unrealistic: one only needs to look at the delta between the estimates of two of the leading modellers in the world (WIK and Analysys Mason) to show how unrealistic that is. That is a further example of the problems of relying upon the 2006 judgment.

20.3 As we have submitted, there is considerable danger in draft decisions being used for signalling purposes, as the minority Commissioner and Chorus propose should happen (the majority Commissioners carefully and correctly record the dangers in such deliberate signalling). Spark in its August 2015 submission puts the point well when it notes that such deliberate signalling by the Commission may constitute pre-judgment.

[107] Chorus 13 August submission at [287.8].
[108] UCLL draft determination 2 July 2015 at [851]. We have also submitted extensively on this particularly in our February and August backdating submissions.
[109] See for example Chorus 2 July 2015 submission at [285].
[110] See for example Chorus 2 July 2015 submissions at [287.9], [295] and [313].
[111] See for example Chorus 2 July 2015 submissions at [287.9].
[112] Chorus13 August 2015 submissions at [295],

21. Efficient price vis-à-vis RSP can be achieved even if not so as to end-user

21.1 Chorus rely on a passage in the 2006 judgment that observes that, while it may not be possible to rectify the price paid by the end-user where there is backdating, the most efficient price, which involves a wealth transfer between Telcos, can at least be established between Chorus and the RSPs.[113]

21.2 As with all material matters arising out of the 2006 judgment, other than our threshold submission that there is no entitlement to backdate, the above conclusion is obiter and non-binding.

21.3 Whether to backdate is predominantly a s 18 issue. Therefore whether to backdate, and how, is assessed via the sole test, namely, promotion of competition for the LTBEU (as refined in sections 18(2) and (2A). That requires assessment of the position from the perspective of the end-user. It requires, so far as possible, empirical analysis, and consideration of all market factors. The most efficient price is but one factor, albeit an important one. In light of our commentary on the Sapere report, we cannot see how backdating (to take money from RSPs and give it to Chorus) promotes competition in the LTBEU. A detailed analysis is required.

22. An FPP "review" does not require backdating

22.1 Chorus rely on the 2006 Court of Appeal judgment's observation that the FPP "review", without confirmation that it has only prospective effect, retrospectively applies.[114]

22.2 "Review" however is not a word that always connotes retrospectivity. It is frequently used in contexts which are only forward-looking. We have submitted, for example by relying on the subsequent English Court of Appeal decision in Vodafone v BT and Ofcom, that the context is one of ex ante regulation, and that the Act should be interpreted as prospective only (or that application of s 18 should be biased toward being prospective, thereby limiting backdating).

22.3 Interpreted in context, both within the Act and broader context, "review" is readily capable of an interpretation that is only prospective (or is biased toward prospectivity).

23. Mis-use of "time consistency" arguments to support backdating and uplifts

23.1 Sapere raise the matter of "time consistency".[115]

23.2 Time inconsistency can be a legitimate concern for access providers (and access seekers who make investment and business decisions, based on the regulatory environment they operate in).

23.3 Time inconsistency problems can arise where changes the regulator makes, eg revising valuations it had previously determined, undermines expectations about recovery of prudent and efficient past investment or may lead to ex post

[113] Chorus 13 August 2015 submissions at [293].
[114] Chorus 13 August 2015 submissions at [300].
[115] Sapere, Economic Comment on UCLL and UBA Pricing Issues, 11 August 2015, section 3.

expropriation of investment capital. None of this is applicable to the revised draft decisions.

23.4 For the time consistency concern to be relevant there would need to be evidence the Commission's revised drafts would preclude Chorus from recovering the cost of its prudent and efficient past investment (the ex post expropriation). No such evidence has been provided. To the contrary, Professor Vogelsang's views are that Chorus over-recovers by a substantial margin.

23.5 With respect, Sapere has also misapplied the concept of "time consistency" in a number of ways, to the FPP determinations for UBA and UCLL services.

23.6 Sapere argue that "The Commission's approaches to setting prices in the Draft Determination can be assessed as to whether or not they are time consistent by assessing if they would be different if Chorus was at a different point in the investment cycle. For example, would the Commission's reasoning for particular approaches change if Chorus had yet to invest in the network and equipment required to supply the UCLL and UBA services?"[116]

23.7 This question is not an example of time inconsistency. The benefit to end-users from promoting stronger incentives to invest will vary depending on the level of investment that is needed. This will vary at different points in the investment cycle.

23.8 The telecommunications sector is now in the situation where Chorus is investing approximately $60m per annum.[117]

23.9 In 2012 Chorus' investment in capex was $48m. In 2013 it was $69m.[118] In 2014 it was $61m.[119]

23.10 This is in the order of margin of error – compared to the Chorus' valuation of its copper assets of $2.4 billion or the $6.6 billion valuation prescribed by the Commission in its revised draft – and provides minimal justification for uplift.

23.11 Even the amount of capex Chorus' claims wasn't spent due to "ongoing restrictions on discretionary spending as a result of delays in the regulatory final cost modelled pricing process" was minor – approximately $25 - $50m in total capex, and $1m in copper capex:[120]

> Copper capital expenditure was $60 million for the year, with the slight decrease [from $61m] reflecting Chorus' continuing focus on cash management due to the prevailing regulatory uncertainty.

23.12 The benefits also change with the advent of new technologies – the emergence of DSL technology would initially have increased the value of the copper network to end-users, but the emergence of replacement fibre will erode it.

23.13 Time consistency is NOT making the same decision in different circumstances. Time consistency is making the same decision in the same or similar circumstances.

---

[116] Sapare, Economic Comment on UCLL and UBA Pricing Issues, 11 August 2015, para [9].
[117] Chorus, Chorus Annual Report, 2015, page 22.
[118] Chorus, Chorus Annual Report, 2013, page 13.
[119] Chorus, Chorus Annual Report, 2014, page 52.
[120] Chorus, Chorus Annual Report, 2015, page 22 and 23.

23.14 The Commission making potentially different decisions on the basis of different sets of circumstances is not time inconsistent (quite the opposite).

23.15 Sapere stretch time consistency arguments to the extreme situation where the Commission should be concerned about incentives to invest even when no investment is required. Sapere effectively argue that the regulatory response to under and over-investment should be the same, on the basis this would be time consistent.

23.16 It should be clear the extent of concerns about incentives to invest depend very much of the extent of investment that will be required and, accordingly, the point on the investment cycle. The Frontier-Dobbs model that CEG, on Chorus' behalf, applied to the WACC percentile issue is premised on new and deferrable investment requiring a higher WACC than sunk and non-deferrable investment.

23.17 Finally, time inconsistency, if it is material, is only a factor in the s 18 assessment which must be carried out based on quantified analysis. There are multiple reasons why there should be no or limited backdating.

Appendix A. WIK and Network Strategies reports

Areas where the Commission has not dealt with, or adequately dealt with, submitter modelling comments include, but aren't necessarily limited to:

Inadequate optimisation	**Costs too high**
(a) Model still not bottom-up in all respects – WIK note that only minor improvements have been made from the December version of the model, and that "In all other network architecture and dimensioning areas as well as in the area of OPEX and common costs the model still relies on Chorus' actual cost and not on optimised replacement and efficient costs which are derived in a bottom-up modelling sense".[121] (b) Shortest path algorithm does not lead to cost optimal results - WIK note TERA has not demonstrated that applying the shortest path algorithm for the trenching cost would result in higher costs. (c) The Commission has not addressed WIK's alternative approach to determination of opex (instead continuing to rely on an Chorus' actual costs with efficiency adjustments. (d) WIK demonstrated in their February Submission that network efficiency of the copper access network could be optimised by endogenously deriving the number and location of cabinets. (e) TERA just relies on assertion that efficiency savings would	(g) Switch parameters of the model still outdated – as per WIK's February submission. (h) WIK – use of one lead-in cable per dwelling remains inefficient (i) WIK demonstrated in their February submission that fibre cabling costs could be reduced in the model by using larger cable sizes. TERA's response that this is not in Chorus' asset list limits the modelling to that of Chorus' rather than an efficient service provider. (j) WIK – the number and location of street cabinets remain inefficient (k) WIK proposed in their February submission to aggregate the core network cables to larger cables because of cost savings and synergies Core cabling still inefficient (l) WIK – costs of joints significantly inflated and overpriced compared to European regulator models. (m) WIK - not efficiency test conducted for submarine and microwave links. Chorus' actual link structure has been applied. (n) WIK – eequipment choice should be supplier neutral. WIK have shown Chorus'

[121] Wik-Consult, 12 August 2015, para [293].

be negligible to ignore WIK's recommendation to use the same street crossing trench in case of neighbouring buildings. (f) Optimising the entire core for trench optimisation – WIK demonstrated in their February Submission that it is necessary to design an efficient national NGN network in order to optimise trenching costs.	equipment costs can exceed those of other New Zealand operators. (o) WIK – Chorus' list prices which have been relied on do not reflect volume discounts (p) WIK – Duct prices too high – TERA has mixed up data leading to significant overestimation of the duct material costs (q) WIK's February submission should that site costs are overstated by a factor of two compared to European cost models based benchmarks (r) WIK – Costs for active equipment too high – generally there isn't an efficient choice of equipment of different sizes in the model: "This holds true especially for the DSLAMs, which are too large for most of the cabinets they are deployed in, and where significant customer growth cannot be expected".[122] (s) WIK – No efficiency considerations conducted for non-network costs. (t) WIK - use of dual UCLL and UBA MEAs results in inefficiencies. (u) WIK – cost modelling should reflect that lowest cost option would be a mix of fibre and copper (just as a copper network would also rely on FWA). This assessment should be conducted per exchange. (v) WIK - Efficiency of modern trenching technologies not considered: "Modern trenching technologies include mini- and micro-

[122] Wik-Consult, 12 August 2015, para [349].

	trenching. These are not considered in the new BECA report and the trench cost used in the model despite the fact, that Chorus is already using these technologies as new and efficient deployment form, like other cost saving improvements also".[123] (w) WIK – Efficiency improvements for OPEX over time still ignored.
FWA	**Other**
(a) The Commission has not adequately addressed WIK and Network Strategies' FWA concerns, replacing one flawed model with another, even though Network Strategies has provided an appropriate model for determining FWA cost and ensuring FWA is applied where it would be lowest cost/most efficient.	(b) Network Strategies – ongoing issues with model accuracy:"A number of key model assumptions should be reviewed and corrected, and inconsistencies between the Commission's stated approach and the model must be addressed. In particular we recommend: • modification of price trends • revision of asset beta, notional leverage and interest rate swap estimates for the WACC • including allowances for multiple connections at single address points • correcting aerial assumptions • ensuring consistent reasoning in the application of subsidy allowances in the model • rectifying errors identified by our Geographic Information Systems (GIS) analysis".[124] (c) Network Strategies: "Given the Commission's constant demand assumption coupled with the very long regulatory period, we have identified a significant risk that prices will be based on a level of demand that bears no relationship to actual market

[123] Wik-Consult, 12 August 2015, para [371].
[124] Network Strategies, Revised draft determination for the UCLL and UBA price review, 13 August 2015, page Iii.

	demand. Demand drivers for the fixed line market are currently undergoing significant changes, and a forward-looking model should reflect this in order to avoid overstatement of unit costs".[125] (d) WIK – Discrepancies remain in the demand figures. (e) WIK – Dimensioning the network for more than 100% of demand remains an error (f) WIK – evidence that double-recovery of costs remains unsolved. (g) WIK – Deficiencies in the data generation process remain. (h) WIK – BECA's approach to determine trenching costs still cannot be verified. (i) WIK – Difference of copper connections of the model and Chorus numbers remains unexplained. (j) WIK – Overlapping of non-TSO and FWA coverage area remains.

[125] Network Strategies, Revised draft determination for the UCLL and UBA price review, 13 August 2015, page iv.