

**UBA AND UCLL FPP Price Review  
Determinations – Memorandum for Cross-  
submissions on behalf of Orcon**

**30 April 2014**

Public version (there is no confidential version)



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## 1. Introduction and Summary

1.1 This report supplements Orcon's cross-submission.

### ***MEA must be scorched earth: rural and semi-rural***

1.2 In the first part of this memorandum, we conclude that the legislation requires a scorched earth modern equivalent asset (MEA). Unlike other countries where scorched nodes are used, a scorched node MEA is not permitted. In any event, in the world of FTTH, it is no longer a viable option from a legal perspective, as a scorched node network is not a sufficiently relevant MEA.

1.3 Our Act expressly requires **solely** forward looking costs and therefore cannot use historical costs. It cannot use scorched nodes as that inevitably involves historical costs. The short cut taken by regulators overseas to reduce the scale of the exercise cannot be used here. A legislative requirement overrides TSLRIC methodology elsewhere. The Act materially defines TSLRIC as follows:

“TSLRIC....means the forward-looking costs....”<sup>1</sup>

1.4 In any event, modelling a scorched earth MEA would appear to be not much more complicated than modelling a scorched node MEA as:

- (a) TERA say that new software, with GPS mapping, enables such modelling in straightforward fashion;
- (b) The location coordinates of the end user locations remain the same;
- (c) There are fewer nodes in the hypothetical new network especially if it is FTTH.

1.5 No operator in green fields would install a copper network, including FTTN. This implies an FTTH scorched earth MEA.

1.6 We focus on the urban footprint, largely because the material produced so far has been light outside that footprint in terms of options such as FWA and mobile. The footprint of the two services being priced is the current DSL footprint. So it is better to refer to “semi-rural”. The principles we outline as to urban apply also in semi-rural.

1.7 Given the nature of the information requests made and not made, it appears that the Commission is not considering mobile as a MEA. That the Commission is not doing so implies there may be problems elsewhere: the Supreme Court found that the Commission erred in law by failing to adequately use mobile in the materially similar circumstances of the TSO determinations. There are some differences in methodologies between the TSO and the PRD but in this and other respects the issues are largely the same. Compliance with our Supreme Court's judgments would be one of the first things to do, implying there may be oversights elsewhere. (The judgment also deals with another parallel issue: the inappropriate use of PSTN exchanges as scorched nodes relative to the mobile assessment).

### ***Full quantitative MEA assessment***

1.8 In the section below on timing, we outline the need, for a number of reasons, for a robust quantitative assessment to select the most appropriate MEA. We consider that

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<sup>1</sup> Schedule 1 definition of TSLRIC.

the High Court Input Methodologies (IM) judgment means this is required. (Put another way, the litigation risk of not doing so is too high). The 57 page (plus financials) MEA assessment done by TERA in Denmark but seemingly not done here at the same level appears problematic. There is no reason for a lighter approach in this country and, as noted below, the Act, properly interpreted, requires an internationally consistent approach.

### ***A counterfactual approach***

- 1.9 The Commission is modelling the hypothetical equivalent of a copper network. In other words, if you remove that copper network, what would the hypothetical operator build?
- 1.10 That hypothetical operator would still have available (as its own asset and/or as a third party asset) the UFB network built and being built by Chorus and the LFCs. Those assets are being (or would be if needed to replace copper) built more quickly than a standalone build for a replacement network.
- 1.11 The operator would roll out its service over those assets. (Similarly in semi-rural areas where existing towers, base stations and back haul are available for mobile and/or RBI, as is fibre). Thus, there are shared costs (both the operators' own shared costs and the price estimated to be payable to third parties). Account of current shared use of ducts would be needed.
- 1.12 This also points to an FTTH MEA being the only viable MEA in the real world: the counterfactual.

### ***Chapman Tripp propositions***

- 1.13 Just as we have proposed a clear set of principles for the application of s 18 and the treatment of adjustments of WACC away from the mid-point, as this helps provide certainty for the Commission and stakeholders, we agree with Chapman Tripp that a set of principles is useful. We agree with many of their proposed principles, disagree with others and, in particular, consider that the Chapman Tripp principles should be augmented to take account of related matters: without that, and without careful reference to underlying definitions and methodology, the principles can lead down an incorrect path.
- 1.14 In the box at the end of this introduction, we have stated, following Chapman Tripp's lettering, our proposed principles. In Appendix A, we have set out, in track-change, the changes from the Chapman Tripp principles.
- 1.15 In our commentary on the principles we have drawn a number of related conclusions relevant to a number of modelling issues.

### ***Timing***

- 1.16 All parties but Chorus have expressed considerable concern at the speed of this process. In this memorandum, we deal with some of the risks that the Commission appears to be taking by such a quick process, contrary to what happens overseas, including in Denmark where the work of TERA provides valuable benchmarks. For example, the Commission does not appear to be in a position to explain why the approach in New Zealand would be such an outlier in TSLRIC pricing, when on most issues it must follow international methodologies, given the Act is interpreted in context and a key contextual matter is the overseas TSLRIC experience.



- 1.17 The risk is not necessarily that an RSP might litigate. But, rather, while there will always be litigation risk in this matter which the Commission largely cannot avoid (such as in relation to interpretation issues), it seems likely that a disaffected party (Chorus, RSPs, and/or consumer bodies) will take action by appeal and/or judicial review based on timing and process issues. On present information we would expect such a disaffected party to do so, based on (a) what it might see on discovery and OIA enquiries, and (b) expert evidence from distinguished and experienced former regulators. This seems to be too high a risk by a substantial margin and not at all in the interests of s 18 consumer welfare.
- 1.18 The information requests indicate that the Commission may not be intending to change tack, despite what seem to us to be compelling points made in the RSP and InternetNZ submissions. Hence our clients have asked us to submit firmly, albeit with some regret at the need to do so. Their focus is not to say they might sue but rather to indicate that some party might, and also to provide assistance to the Commission to strengthen its processes so there are better outcomes.

### **Glossary**

- 1.19 We have used the definitions adopted in the CallPlus/Orcon submission, and repeated those in Appendix B below. What is apparent is that incorrect use of the words and the statutory framework can lead to errors, which in particular leads to poor policy outcomes.

### **Principles**

- (A) *The Commission is a creation of statute, and its functions and powers in relation to a PRD are both provided and limited by the Act.*
- (B) *In undertaking a PRD exercise, under Part 2(4) of the Act, the Commission is required to comply with all of the provisions of the Act.*
- (C) *Insofar as the courts have analysed and opined on the purposes and provisions of the Act, the Commission is required to apply those analyses and opinions in the same way that an inferior court applies superior court decisions (that is, based on the doctrine of precedent).*
- (D) *Insofar as the Commission has a discretion or judgment to make under the Act, including in deciding various issues that go to making a PRD, that discretion or judgment is not unfettered but must be exercised lawfully, rationally, having regard to the Act as a whole, and other relevant considerations including context. This is a two-step process:*
- *Firstly, the Commission obtains and analyses the evidence on the cost/TSLRIC of the service. Section 18 has no role at this stage. Any discretion or judgment is based upon what will produce the best estimate of TSLRIC (that is, a purely cost-focussed approach).*
  - *Secondly, the Commission must “consider what s 18 tells it*



*as to where the.. price should be set, within a plausible range for TSLRIC.”<sup>2</sup>*

- (E) *While the purpose of the Act is to provide for regulation of certain designated telecommunications services, and the provisions of the Act are paramount, the avoidance of unnecessary and damaging constraints being imposed on an access provider's economic existence is a relevant consideration. However, this is a consideration if and only if that “promote[s] competition in telecommunications markets for the long-term benefit of end-users of telecommunications services” under s 18. That is solely a consumer welfare consideration. The interests of Chorus and its shareholders and investors are irrelevant. In assessing s 18 considerations, the Commission must do a sufficiently detailed empirical efficiency analysis.*
- (F) *The structure and logic of the two-stage price determination process (using “initial” and “final” pricing principles) provides a statutory assumption that the PRD (using the FPP) will produce a more accurate TSLRIC-based price for supply of the service regulated under the relevant STD. The price should be as efficient as the TSLRIC model permits.*
- (G) *A PRD necessarily relates to the service which is the subject of the STD, which itself may be narrower than the full Schedule 1 (Part 2, Subpart 1) service description. Other services (regulated and commercial) using the same facilities as the service being priced are relevant to establishing the price, but not as to jointly deciding the price (even though, from a practical perspective, the analysis is undertaken in parallel). The other services are relevant as to the sharing of cost over shared facilities. and the sharing of common cost;*
- (H) *While the service description in Schedule 1 in the Act and/or the non-price terms in the STD may be amended, that generally requires compliance with a meaningful procedure prescribed by the Act, and is irrelevant until and unless a new service description is in place. The exceptions are minor amendments to enable the PRD to be workable: s 52(d) permits minor changes for that purpose.*
- (I) *The TSLRIC FPP is defined in Schedule 1 (Part 1, Subpart 1) in terms of “forward-looking costs”, and plainly contemplates and permits, for the purposes of pricing the service, analysis of technologies other than those actually deployed by the current access provider, **but** the definition and concept of TSLRIC cannot dictate the description or scope of the “service” to which the PRD will apply except for minor changes under s 52(d). The question as to what is the “service” to which the PRD applies is a different question from the separate and*

<sup>2</sup> Chorus v Commerce Commission and Others [2014] NZHC 690 at [176]

*subsequent question: How that service to be priced (including as to what the MEA should be and how it should applied). To ensure that the service is priced upon a MEAt, and not constrained to the same legacy technology, the MEA may not include all the functionality of the underlying service. In any event, a FTTH MEA has the same functionality for UBA and UCLL.*

*(J) The Act reflects a legislative intent or expectation that, at the time of a PRD, access seekers would already be utilising the designated access service as defined in the Schedule 1 service description and the STD, and have reflected and relied on aspects of the functionality of that (described) service in their own (retail) services.*

1.20 We now deal with the need for a scorched earth MEA, followed by dealing with the Chapman Tripp memorandum.

## 2. The Act requires a scorched earth MEA

2.1 In summary, the Commission must use a scorched earth MEA. In view of the definition of TSLRIC in the Act, the Commission's scorched node approach is not available. Additionally, it is likely if not inevitable that the MEA for urban is FTTH scorched earth.

### ***Semi-rural***

2.2 In this section we deal only with the urban MEA but the same principles apply in the semi-rural footprint. The footprint of the two services being priced is the DSL footprint. The Commission's consultation documents have been relatively quiet on how semi-rural connections are to be modelled. (We note in passing that the information requests do not delineate the lines covered by the services and those that are not: that raises further questions as to whether the Commission is seeking the correct set of lines to feed into its model).

2.3 Given no requests of MNOs (save as to Vodafone in relation to RBI), it does not appear that mobile is being considered for the MEA. That contrasts with the Supreme Court's decision declaring the Commission erred in law on the TSO net cost determination by not using adequately using mobile and wireless (plus the matters around the inappropriateness of scorched node exchanges for mobile was at issue too). The apparent error here on this relatively straightforward point on which our highest court has been clear about indicates potential wider concerns beyond mobile.

2.4 The error is further shown by a focus in the information requests solely on RBI as an MEA candidate. Although RBI towers can support mobile in addition to FWA, the focus is clearly not on mobile. Further, RBI, being generally outside the FTTN and UFB footprint, is generally outside the services being priced.

### ***Urban***

2.5 The MEA which it appears that the Commission intends to use is one that uses scorched nodes, with the nodes being exchanges for non-cabinetised lines, and cabinets for cabinetised lines. This scorched node MEA can be an FTTN or FTTH MEA

by using copper or fibre respectively from the nodes to the end-users. (By FTTN we mean a network that is copper from the cabinet or exchange node)

- 2.6 A scorched node MEA inevitably incorporates historic cost and elements of the legacy network. (That is so even if there is some modification of the location of the nodes in the modelling). Exchanges and cabinets would not necessarily be (and often would not be) located in their current positions if the green fields new and hypothetical network is rolled out as an FTTN (or pure copper) network. That in turn affects not only the connection from the cabinet to the exchange but also the copper lines from the nodes to the end users.
- 2.7 A hypothetical greenfields FTTH network would have a different layout from the legacy FTTN network, particularly in the network equivalent to the core network side of the exchange and cabinet nodes, but also on the end-user side too. Note however the observations below on reuse of existing assets including assets available during the regulated period: the hypothetical network would use such assets.
- 2.8 Thus, even assuming optimisation of the core network side of the proposed nodes (such as current pricing of trenching and fibre), a scorched earth MEA (FTTN or FTTH) will involve substantial elements of historical and backward looking cost.
- 2.9 It is commonplace for regulators internationally to use scorched node MEAs. Generally, given the limited material in the Act on TSLRIC, the courts (and therefore the Commission) would look to context in interpreting the Act: key here is the context of international TSLRIC methodology.
- 2.10 However, as is frequently observed, each jurisdiction, and its approach to costing services, is governed by a specific regulatory and legislative framework. This affects and varies the application of TSLRIC in each jurisdiction.
- 2.11 As Chorus observe, the definition of TSLRIC in our Act requires, solely, “forward-looking costs”.
- “TSLRIC....means the forward-looking costs....”<sup>3</sup>
- 2.12 This definition does not permit pricing based on backward looking costs. The Commission must base the TSLRIC price on a fully new hypothetical network (that is, a forward looking network).
- 2.13 The Act does not expressly specify the use of MEAs, but legislation is interpreted in context, having regard to purpose. The context is the well-known TSLRIC methodology, and that includes the use of MEAs. Assuming use of the MEA concept, that MEA must ultimately produce prices that are solely based on forward-looking cost.
- 2.14 While the Act is clear about forward-looking cost, that does not require modelling of the hypothetical network down to a detailed level of granularity. Some extraction and estimation is appropriate. Data from the legacy network can be used, along with other information, so long as it produces, strictly and solely, forward looking costs.
- 2.15 However, the use of a scorched node FTTN MEA, even with some modification, is too far removed from the FTTN network that would be built in greenfields. That would not fall within a reasonable estimation of forward-looking costs and the estimate must solely be forward looking costs.
- 2.16 The point is even clearer as to a scorched node FTTH MEA:

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<sup>3</sup> Schedule 1 definition of TSLRIC.

- (a) The real-life FTTH nodes, such as central offices, would bear no relationship to FTTN based nodes, whether hypothetical, legacy or modified legacy nodes. That is as to location and also as to the physical nature of the central offices and other assets.
  - (b) The hypothetical FTTH MEA cannot be extrapolated and estimated from a scorched node FTTH. Put another way, it would not be correct to extrapolate FTTH MEA cost from the – different – scorched node model when the FTTH MEA can be modelled directly. They are too different.
  - (c) Additionally, it is not appropriate to even try to use a scorched node FTTH MEA, when the hypothetical FTTH network can be modelled directly. In any event, from the TERA workshop, it was apparent that street by street modelling is greatly simplified, relative to modelling in the past, by the use of modern software. Therefore, such modelling from a central office should not be significantly more complex than modelling from cabinets and exchanges and could be easier given fewer network end nodes. But even if it is more complex, the issues at stake for providers and end-users are considerable and the legislative framework would not permit undue compromise.
- 2.17 Significantly, the decision around choice of MEA in New Zealand is being made in a context that is quite different from the choices made in most if not all of the other jurisdictions. Those choices were often made when the replacement network was likely to be similar to the legacy network (that is, a copper only network or an FTTN network). Even when the decision is currently being made, the historical choice of MEA may be relevant, as, for example the TERA MEA assessment document in Denmark shows). If the MEA was going to be similar (e.g.copper based), it may have been appropriate to extrapolate the hypothetical network from the legacy network on the core network side of the nodes. But now there is a MEA candidate – FTTH – which is very different.
- 2.18 This is the first time, absent modelling in the early 2000s when fibre was not on the cards, that New Zealand is dealing with this issue. FTTH is in fact the network that would be installed in greenfields. There is no prospect that a copper network would be built now if no copper network existed, which is the key assumption. In the current environment, it would not be correct to extrapolate an FTTH network from a scorched node FTTH MEA using legacy cabinet and exchange nodes. That is an unnecessary complication and would reduce the quality of the TSLRIC estimate.

### ***Conclusion***

- 2.19 In the end this comes down to a simple statutory conclusion. Our Act expressly requires **solely** forward looking costs and therefore cannot use historical costs. It cannot use scorched node as that inevitably involves historical costs (the more so as network technologies such as FTTH and mobile move away from legacy network layouts).

### ***Ascertaining price from a scorched earth MEA***

- 2.20 We agree with Chapman Tripp that there are two sequential steps not to be conflated or mixed:
- (a) What is the service being priced (which is the service as stated in the STD)?
  - (b) What is the MEA of that service which is used to derive cost and therefore the price of that service?



- 2.21 The UCLL service (NUCLL and SLU) does not include the cost of the path from the cabinet to the exchange.
- 2.22 If a scorched node or scorched earth FTTN is the MEA, the delineation, especially for SLU lines, is relatively clear to estimate (but with a scorched node FTTN MEA, there are still the problems noted above).
- 2.23 If, as we consider is required, an FTTH scorched earth MEA is used, it is still the service in the STD that is being priced, that is:
  - (a) As to UBA, the path from the end user back to the geographic location of actual exchanges and cabinets.
  - (b) As to UCLL, the path from the end users back to the geographic cabinets and the exchanges respectively.
- 2.24 The cost of those components can be estimated, given the central offices and their locations will generally be different in a greenfields network.
- 2.25 While the FTTH MEA has different features, and that leads to some challenges in estimating the underlying UCLL and UBA cost and prices, that can be done.
- 2.26 Significantly, challenges in estimating cost and price is not a reason to use other than the most appropriate MEA. The considerable difference in price outcomes indicates that estimating challenges are a minor consideration.

### **3. In situ facilities: the counterfactual**

- 3.1 In modelling the hypothetical network, the availability of existing assets, such as third party assets, beyond the copper network that is being modelled are taken into account. That is correctly accepted by Analysys Mason in their reports when they identify the use of reusable assets. They also correctly recognise that such facilities can only be factored into the model if in practice Chorus can use them for the hypothetical network: for example, if environmental or other law does not permit use of poles in a particular area, use of poles is not factored in.
- 3.2 Additionally:
  - (a) The cost to be used for third party assets such as poles would be the best estimate of the likely price that Chorus would have to pay the lines company.
  - (b) The cost to be used for the use of Chorus's own assets (that is, assets beyond the copper network) would be cost in a TSLRIC sense.
- 3.3 It is important to assess price based on the cost of a hypothetical network if the assets being priced (that is, the copper network including the fibre backhaul from cabinet to exchange) are not available. That would mean that UFB for example would be in place as that is not the network being priced.
- 3.4 Another reliable way of addressing this issue, consistent with the ubiquitous approach in competition law and regulation, is to assess it from a counterfactual perspective. If the copper network is removed, how would Chorus, if it operated as an efficient operator, roll out its replacement network?
- 3.5 Chorus, if rolling out a new network today, to replace its copper network, would certainly use its parallel UFB network. So would any other operator, which means also that

Chorus would use the LFCs' networks for its services in their footprints. The UFB networks (Chorus's and LFCs are all existing networks not taken away in the copper network).

- 3.6 Additionally, in this assessment the price being modelled is the price for the regulated period. From the information requests of Chorus it seems that is assumed to be 5 years, but in any event, take 5 years to illustrate the point. What is being modelled is what happens over that period and not just what happens at the start of the period.
- 3.7 During that period, UFB will be fully or nearly fully rolled out (and in the hypothetical scenario it would be rolled out more quickly anyway to meet the hypothetical gap, and certainly at least as quickly as a standalone network would be rolled out). Thus, the separate networks for UFB, which in the counterfactual and in real life are happening anyway, will be available.
- 3.8 The hypothetical network (the MEA) will use the Chorus UFB and LFC networks (fibre, ducts, etc).
- 3.9 On the Chorus UFB network, the cost for the MEA (that is the MEA for the UCLL and UBA services) would be based on the same approach to sharing of facilities and paths as between, for example, UBA, UCLFS, UCLL and commercial services over the copper paths. Over the LFC's network, the cost would be the estimated arms-length price payable to the LFCs for use of the networks.

#### **4. FTTN MEA: the nature of the build**

- 4.1 If we assume an FTTN MEA is used and UFB infrastructure is not available for the modelling, contrary to our views above, a question arises as to how the hypothetical network is to be built. The choices can make a large difference to cost. For example, while a ducted network is substantially more expensive to build than a pole-based network, the former has a longer life and/or lower maintenance/opex cost than the latter.
- 4.2 Approaching this from a counterfactual perspective, which we consider is correct as outlined above, the counterfactual has the UFB network replacing the hypothetical FTTN network, and therefore Chorus would not, in those hypothetical circumstances, roll out a belt-and-braces ducted network (except where, for example, a poled network is not available). The UFB network would replace the hypothetical network so the latter's life does not have to be long: a poled network would meet the needs even though its life may be shorter.
- 4.3 Further, access seekers and therefore consumers, should not have to pay based on a hypothetical network that is more robust and costly than it needs to be to meet the requirements of a modern equivalent asset.

#### **5. Chapman Tripp opinion : areas of agreement and disagreement**

- 5.1 We agree with much of the Chapman Tripp opinion, but disagree with some conclusions. Additionally, by singling out single issues, Chapman Tripp does not deal with key related issues.
- 5.2 Chapman Tripp describe a number of their propositions as non-controversial, when they are controversial and/or incorrect.

- 5.3 In this opinion we identify the points of agreement and disagreement, in a manner designed to identify common ground, and to provide greater certainty and clarity for the Commission and stakeholders.

***Having a set of principles is valuable***

- 5.4 As has been outlined previously, we consider that it is valuable for the Commission to develop a series of principles – as Chapman Tripp has done in their list of propositions. That will reduce some of the current uncertainty. Certainty will provide a framework that will help the Commission and stakeholders going forwards. Applying a set of principles will make the process clearer and easier. We recommended that also in relation to the application of s 18 – such as the two step process, with s 18 applying only when a plausible range is reached<sup>4</sup> – and in relation to principles applicable to WACC and movement from the mid-point.<sup>5</sup>
- 5.5 Crucially, however, any set of principles at this stage is (a) subject to development on particular issues and (b) necessarily incomplete. Thus, while we have marked up the Chapman Tripp principles in the Appendix, by track-change to show points of agreement and disagreement, this is a work-in-progress.

***Clarity is essential***

- 5.6 An overall point that emerges is that:
- (a) The Commission and stakeholders need to be clear about the steps in the processes and what they are called.
  - (b) We agree with the clarity and the approach Chapman Tripp take in this regard. However, they do not, on all issues, maintain that clarity, especially as to the distinction they correctly make between:
    - (i) The service being priced; and
    - (ii) The MEA of that service, from which the price flows.
  - (c) When this is corrected, different outcomes emerge.

***Price each of the services separately, but they are not standalone from each other***

- 5.7 We also agree with the Chapman Tripp view that each of the 3 services are to be priced separately, even though for practical reasons the position is modelled in parallel. As Chapman Tripp say at [5.2]:

“while parallel work may be efficient and permissible, a PRD process for that service must not produce a joint analysis which establishes a price applicable to both that service and any other service subject to any contemporaneous PRD for a separate service. Thus, in the present case, the Commission must make separate PRDs in respect of the UCLLSTD and SLU STD services, as well as the UBA service”

- 5.8 However, that is only a part of the story. Crucially, as is well known for TSLRIC modelling, the services cannot be modelled in isolation from each other, and in isolation

<sup>4</sup> And this approach has been applied by Kos J in his judgment

<sup>5</sup> As outlined in the Orcon submissions on the Commission’s FPP WACC discussion paper.

from other services being provided over the same paths such as commercial services. Therefore, we have added to the relevant Chapman Tripp proposition to emphasise that the three STD services (and other regulated services such as UCLFS and also commercial services) feed into each PRD, as they share the same facilities and contribute to cost. There is an interplay between the services at this level during each PRD. Further, as outlined below, the relationship between the regulated services is relevant to how they are priced and modelled.

- 5.9 However, how the services interplay must be carefully delineated and it appears that this may not yet have happened adequately.
- 5.10 We turn now to the propositions where we differ, as set out at Appendix A.

## 6. Proposition C: Commission to apply court analyses and opinions?

- 6.1 Chorus appears to say that the approach to court decisions should be different from, say, the approach of the High Court in applying a Court of Appeal judgment. It is said that any opinion or analysis by a court must be followed by the Commission.
- 6.2 It is not at all clear how such a proposition would be applied in practice. When would a particular opinion or analysis apply to the facts and issues faced by the Commission in a particular circumstance, given the myriad of circumstances that differ from the matter decided in the judgment?
- 6.3 Inevitably, that leads back to how an inferior court applies a superior court judgment. All the usual precedent rules would apply in practice for the Commission. Is the judgment on point and therefore binding (in which event the Commission must follow it)? Or can it be distinguished (in which case it is not bound by the judgment)? That is an appropriate step for the Commission where the circumstances make that appropriate. Is the decision obiter? If yes, the Commission, like an inferior court, has regard to the judgment but is not bound by it. All that makes sense: being obiter, the judgment may not have had full analysis on the point and thus the Commission may rightly decide not to apply it. Its position in that regard ought to be no different from an inferior court.
- 6.4 We cannot see why the approach of the Commission should be any different than the approach of an inferior court. The applicable policy considerations are the same in both cases. In the end, the judgment is either binding and applicable, for demonstrable reason, or it is not, and there is no reason to depart from well accepted precedent principles.

## 7. Proposition D: Commission to act within the legislative framework

- 7.1 We agree that the Commission must exercise its discretion lawfully, rationally and having regard to the Act as a whole and other relevant circumstances. It follows from *Chorus v Commerce Commission*<sup>6</sup> that the application of s 18 must be clearly delineated to two separate sequential steps. The Court observed, in a passage equally applicable to the FPP process, at [176]:

[176] Secondly, I have held that the Commission considered s 18 appropriately, and that it was entitled to focus on that consideration after analysing the international benchmark evidence for price setting comparability, country comparability and service similarity. That

<sup>6</sup> *Chorus v Commerce Commission and Others* [2014] NZHC 690

exercise, in my view, is evidence-based, and does not require adjustment for s 18 considerations. Having isolated the relevant evidence, and having identified its benchmark data, the Commission must then consider what s 18 tells it as to where the IPP-based price should be set, within a plausible range for TSLRIC. The Commission did that. This approach was one open to the Commission to take. It did not err in law in the second respect alleged by Chorus.

## 8. Proposition E: Chorus property rights?

- 8.1 The position is the opposite of what is stated by Chapman Tripp as an uncontroversial principle.<sup>7</sup> The interests of Chorus and its investors are expressly irrelevant rather than relevant. Their property and economic rights are expressly ousted.
- 8.2 The Act regulates the prices Chorus can charge, based on cost. That starts the removal of economic and property rights in a fundamental way.
- 8.3 As the April 2014 appeal decision confirms, the Commission first determines the cost of the service. Only when it gets to a plausible range do s 18 discretions arise.
- 8.4 Section 18 expressly is limited solely to long-term benefit of end users (LTBEU), efficiencies and s 18(2A) considerations, all solely from the perspective of the consumer, meaning that Chorus and investor interests are expressly irrelevant. The access provider's concerns are only relevant to the extent that their interests promote competition from the consumer's perspective. For example, an access provider being able to charge a higher price is a consideration that is relevant only if that benefits competition from a consumer welfare perspective. Thus, Parliament has expressly ousted any property right interpretation and application of the Act.
- 8.5 The incorrect approach by Chapman Tripp is apparent from this extract from their opinion, citing first Section 278 from *Bennion on Statutory Interpretation* (and then at [11] Chapman Tripp comment on this):<sup>8</sup>

**“Section 278 Statutory interference with economic interests**

One aspect of the principle against doubtful penalisation is that by the exercise of state power the property or other economic interests of a person should not be taken away, impaired or endangered, except under clear authority of law.

- 11 To be clear, we do not contend that Proposition (E) and the common law entitlements directly constrain a clear statutory discretion, but they remain within the range of considerations relevant to the exercise of a regulatory discretion. As it happens, in the context of the Act, and its section 18 purpose provision (not least the section 18(2A) references to investor risks and innovation incentives), this proposition is effectively subsumed into the incentives necessarily associated with long-term investment and fostering dynamic competition.”

- 8.6 Contrary to the Chapman Tripp view above, but consistent with the passage cited from *Bennion*. the Act takes away the property or economic interests of Chorus and its shareholders by “clear authority of law”. First, the price at which they must provide regulated services is clearly constrained by statute. Second, the very provision that

<sup>7</sup> At Para 7 of the Chapman Tripp opinion.

<sup>8</sup> At Paras [10] and [11] of the Chapman Tripp opinion

addresses investor incentives and risks in relation to new telecommunication services such as UFB – Section 18(2A) – expressly excludes consideration of the interests of Chorus and its investors. Put another way, the economic and property interests of Chorus and its investors are expressly ousted by “clear authority of law”, contrary to what is contended on behalf of Chorus.

- 8.7 As submitted previously by Orcon and CallPlus, if s 18 is to be applied, a comprehensive empirical analysis is required, from a consumer welfare perspective. This must be wide ranging across efficiencies and markets. It is far from enough for Chorus merely to assert that it and other interests are affected. Moreover it is up to Chorus to provide the evidence and analysis, as the IM judgment confirms. In our view, the requirement for a quantitative analysis, similar to that required for the WACC assessment, is required by the IM judgment. Putting that a different way, the litigation risk of not doing such analysis is too high.

## 9. Proposition F: FPP more accurate than IPP

- 9.1 We agree that the FPP should produce a more accurate price than the IPP, but we consider that it is important to be clear about what is happening. It produces a more accurate **TSLRIC-based** price, rather than necessarily, as Chapman Tripp states, an **efficient** price. Some of the approach thus far by stakeholders produces substantive errors due to incorrect use of words and processes. While the TSLRIC-based price might be the most efficient, it could well be different. Indeed, it is generally regarded by most experts as different, as TSLRIC is considered to produce excessive returns to access providers, especially as to end-of-life networks such as copper. It would be wrong to equate a TSLRIC price with the most efficient price, and the Commission should be careful in our view to distinguish the two. The TSLRIC price is likely to be an inefficient price.
- 9.2 However, within the TSLRIC construct, the price should be as efficient as is achievable. For example, the network to be modelled should be the most efficient that is achievable within the TSLRIC construct.
- 9.3 The application of s 18 illustrates why the Commission should be clear about this. A s 18 analysis should reflect true and reliable efficiencies, and not what is generally regarded as inefficient: a TSLRIC price in relation to an end-of-life network. The s 18 assessment is not constrained by the limitations of TSLRIC. It can and must be a real world analysis focussed on efficiencies.
- 9.4 While the sort of quantitative CBA that we consider is required will avoid the need for a high level approach, the Commission can, in its s 18 analyses, conclude that TSLRIC produces an inefficient price in current circumstances.

## 10. Proposition G: Services to be priced separately?

- 10.1 We agree that it is each of the three services in the existing STDs that is being priced, and not the high level services as described in Part 1 of Schedule 1. Essentially, the service, based on the non-price terms in each STD, is priced. This is for the reasons in the JEP1 opinion, and as explained in the Chapman Tripp opinion.
- 10.2 This means that, for example, as outlined in the Orcon/CallPlus submission, UCLFS, UCLL and UBA are not priced together.
- 10.3 It is important to note in this regard that, even though UCLFS is priced based on the NUCLL price, the UCLL service (NUCLL and SLU) is not being priced for the UCLFS

service, nor priced based on cost elements in that service. They are only relevant to the extent that UCLFS over shared paths leads to shared cost and therefore reduced UCLL and UBA prices. UCLFS use of shared paths is calculated based on forecast demand.

- 10.4 As Chapman Tripp correctly observe, the services can be modelled and priced at a practical level in parallel, as that is an efficient and practical approach, but the services are priced separately. This is appropriate so long as the requirements of the legislation, and TSLRIC methodologies, are carefully followed.
- 10.5 We don't understand Chapman Tripp to be saying otherwise.
- 10.6 We have expanded Chapman Tripp's proposition to deal with an insufficient approach that appears in particular from the information requests, particularly what they do not contain. Shared cost between services – commercial and regulated – is a critical part of the TSLRIC methodology. There are questions such as:
- (a) What those services are, taking care to delineate the services?
  - (b) To what extent is cost incremental as opposed to shared?
  - (c) What is the forecast demand for the relevant services?
  - (d) What are the methods by which cost is allocated between services?
  - (e) What is the position on those matters estimated to be over the regulated period (which may be 5 years according to the information requests)?
- 10.7 We could see little in the requests dealing with those last three questions. So that raises an issue as to whether the approach is correct.
- 10.8 We consider that TERA's draft Model Reference Paper (MRP) in Denmark (and the final version if it is produced in time: TERA can advise on that) is a valuable start. Overall, we do not get the sense from the information requests that the level of approach is similar to that in Denmark. For example the requests ask for most information as at today and not on a forward-looking basis. The Commission must estimate what is going to happen based on facts over the relevant period.
- 10.9 Another example is that there is no sign that information is sought to undertake the shared cost analysis by the more complex of the two options recommended by TERA in Denmark in their draft Model Reference Paper. The less complex (based on the busiest hour) is highly favourable to Chorus, given high bandwidth use by broadband and low bandwidth use by UCLFS. It may be that timing constraints will drive use of the busy hour approach, thereby benefiting Chorus. This ought not be. This is an example of the problems caused by not having enough time. On this issue alone, the effect could be substantial
- 10.10 We return to UCLFS as an illustration:
- (a) As we note later in this memorandum, the NUCLL IPP on 24 April will under-recover the UCLFS price.
  - (b) Shared use of cabinet to exchange ducts (copper by UCLFS and fibre by UBA) is shared cost and contribution from UCLFS is to be factored into the UBA price despite that under-recovery (as outlined below, one aspect of the UCLFS under-recovery is that the UCLFS IPP does not recover all of the cabinet to exchange cost attributable to UCLFS)..

- (c) If PSTN functionality is a part of regulated services, for fax, alarm monitoring, TSO etc, those are services that are supplied only over UCLFS, and the cost would only be recovered from UCLFS. (We explain that in more detail below). To be clear, UCLL is not an input into UCLFS.
- (d) Put another way, fax, TSO, etc are incremental services independent of UCLL and UBA.
- (e) That is an issue that can only be dealt with on an UCLFS PRD or a s 30R review.

## 11. Proposition H: Service description governs

- 11.1 With one exception, the non-price terms in the STD provide the terms and description upon which each of the services (UBA, NUCLL or SLU) are priced. The prospect of later change, such as under Schedule 3 or s 30R, is irrelevant. It is the existing services that are being priced.
- 11.2 In the interests of clarity, we have added the non-price terms in the STDs to this proposition. It is useful to see the PRD process as pricing the non-price terms in the STD. That is clarified by s 42(1).
- 11.3 The exception is a limited one. Section 52 (d) enables the Commission to include “terms and conditions (if any) on which the [PRD] is made”. We agree with Dr Every-Palmer that this is a limited power, and not focussed on changes in non-price terms. We see this provision as primarily facilitating terms such as glide paths. However, there may be minor terms and conditions, which in effect impact non-price terms, to enable the PRD to be workable.
- 11.4 As the service description governs, and Chapman Tripp accept, it is not apparent why the service being priced must have functionality that is not stated in the STD, such as TSO, fax capability etc. it is not surprising this is not stated, as neither UCLL nor UBA delivers that functionality: UCLFS does that instead.

## 12. Proposition I: TSLRIC cannot dictate what the “service” is

- 12.1 We agree with Chapman Tripp’s proposition but it leads down the wrong path in isolation and so we have added to the proposition.
- 12.2 First, it helps to add, to give clarity, a point also made by Chapman Tripp in their opinion: there are two separate and sequential questions:
  - (a) What is the service being priced; and
  - (b) How is it to be priced (including as to choice and application of the MEA)?
- 12.3 If the MEA has to closely mirror the functionality of the underlying service, then, internationally, for all regulators using TSLRIC, the economic and policy objective of using a MEA would be lost. The MEA would almost always be the same or very similar to the legacy service.
- 12.4 Given those economic and policy objectives, and given that legislation is interpreted in context (that is, the TSLRIC model internationally, s 18 etc) and having regard to purpose, the Act should be interpreted such that the MEA does not need to be a mirror of the underlying legacy service. That outcome can and should be achieved applying standard statutory interpretation principles.

- 12.5 However, in any event, an FTTH MEA does have the required functionality of the underlying service:
- (a) The features referred to by Chorus such as fax, alarm monitoring, TSO, etc, are all delivered:
    - (i) Over the low frequency; and
    - (ii) Over the separate service which is UCLFS, which is a low frequency service.
  - (b) UBA is a high frequency service and UCLFS is a different regulated service (to be costed and priced separately: see e.g. CI 4B Sch 1).
  - (c) Thus, UBA does not deliver the services to which Chorus refers such as fax and TSO.
  - (d) The fact that UBA and the low frequency services share the same path does not mean that the low frequency services are part of what is being priced. (They are relevant however to shared cost and, in turn, reduction of the UBA price).
  - (e) In any event, these services have their modern replacements; for example, we email scanned letters these days rather than sending faxes. TSO copper obligations will be replaced during the regulated period (say 5 years) by technology neutral obligations and/or other technologies such as wireless (and it is what happens in the future that counts, not what happens today: the Commission must estimate the future position not the position today).
  - (f) The same applies to UCLL, given the current use of UCLL (as Chapman Tripp note, that is significant) is for high frequency DSL services and the footprint is the DSL-capable footprint. Based on context and purpose, the correct interpretation is that the UCLL service only recovers the costs in the DSL copper footprint, for high frequency services.
  - (g) Importantly, UCLL is a different service to UCLFS, even though the UCLFS price is linked to the NUCLL price, for the reasons outlined above.
- 12.6 That also means that the copper path for UCLL (being NUCLL and SLU) is materially less than the copper path for UCLFS (for example UCLFS reaches remote areas). Therefore, making the NUCLL price the price for UCLFS – which on 24 April became the IPP for UCLFS - will lead to under-recovery of the UCLFS cost. Plus, as noted above, there is the prospect that, on an FPP, UCLFS will also have a price recovering the incremental cost of PSTN emulation to enable faxes, TSO, etc.
- 12.7 The UCLFS IPP appears to be in error, although that is not surprising given the limited nature of the Chorus and Telecom submissions on the s 30R review concluded on 24 April. While we outline this here, as it is relevant to shared cost, ultimately, UCLL does not recover cost of UCLFS and UCLFS must recover its own cost.
- 12.8 The most useful resource on UCLFS and the IPP is the Commission’s revised view on whether to commence an UCLFS Sch 3 investigation dated 17 August 2012. Para references in this section are to that report.
- 12.9 As the report points out, the 2007 NUCLL IPP was for the network pre-cabinetisation (see [34]). Therefore the NUCLL IPP price could be the “geographically averaged price

for Chorus's full unbundled copper local loop network" which is the material part of the price description for UCLFS (see [68]).

- 12.10 Due to the NUCLL loop lengths dropping by 29% due to cabinetisation (as stated at [39]), the NUCLL price would no longer reflect UCLFS cost (in effect, the cabinet to exchange path is removed from the UCLFS price). That would be so when the price was updated. It wasn't as at 2012 and therefore the Sch 3 review was not needed as the 2007 STD still captured the cabinet to exchange component.
- 12.11 This also means that the new NUCLL price (IPP or FPP) is not what the Act requires: "geographically averaged price for Chorus's full unbundled copper local loop network". The NUCLL price is not the geographically averaged price of that network.
- 12.12 There are additional challenges as in our view, the NUCLL and SLU prices are to be averaged and that would exclude from the UCLL prices (a) copper over the cabinet to exchange path (b) lines outside the DSL footprint (that is, the UBA and UCLL footprint) and (c) any increment for PSTN emulation.
- 12.13 The different definition of the price in the UCLFS service description, relative to UCLL, was significant to the Commission, particularly the reference to "full" (at [64] to [66]). The Commission concluded at [66]:

Both the plain meaning of "full" and the definition of "local loop network" suggest that the reference to "full" in the UCLFS IPP refers to the entire local loop network, including the copper network that passes through a distribution cabinet.

- 12.14 Thus the UCLFS price recovers the cost of the "entire local loop network". The Commission noted at [73]:

If the Commission were to set an updated price for the UCLL STD Service which was based on the non-cabinetised portion of Chorus' local loop network (NCUCLL) only, this price may not be appropriate for the UCLF service. Rather, a price based on FUCLL (which could be different to, or the same as, the UCLL STD Service price) would need to apply to UCLFS in order to be consistent with the IPP for the UCLF service.

- 12.15 In summary, Chorus cannot sort out any under-recovery from UCLL or UBA. It can only do so in the UCLFS FPP price. That includes as to the fax, alarm monitoring, TSO, etc functionality.

### **13. Proposition J: Current use by RSPs is assumed**

- 13.1 If the Chapman Tripp proposition applied then that is confirmation that:

- (a) TSO, faxes, etc are outside the functionality of UBA and UCLL as those services are delivered over UCLFS instead; and
- (b) The footprint of UCLL is the current DSL capable footprint.

- 13.2 However, in applying the STD, there is no simple position that current usage is assumed:

- (a) Rather, the STD is an instrument created pursuant to powers under a statute, and therefore falls to be interpreted applying interpretation principles similar to those applicable to statute. Of course the Act is to be interpreted in that way anyway.

- (b) Where it is necessary to look to context and purpose in interpreting the STD, we think it likely that actual usage will be part of that context, along with other factual matrix considerations.

13.3 It may be that it is contended by Chorus that TSO and fax, etc functionality can be assumed as being part of the service functionality, despite the absence of that functionality in the STDs. For a number of reasons, including the fact that the functionality is provided over UCLFS, we consider that current use does not support that argument by Chorus.

#### **14. Proposition K: TSLRIC abstraction consistent with functionality?**

14.1 Given the observations elsewhere in this memorandum, this proposition should be removed.

#### **15. Proposition L: PRD must be consistent with TSO obligations?**

15.1 Chapman Tripp state as part of their proposition:

*"[I]t would be inconsistent with an overall legislative intent or expectation if the PRD analysis involved assumptions about technology which were inconsistent with, or assumed away, the ability of service providers to comply with the TSO."*

15.2 This is not correct. First, the TSO obligations are no part of the services being priced. The services being priced, as Chapman Tripp correctly state in their Proposition G, are the services as specified in each STD. We also note, as outlined above in more detail, that the TSO is a UCLFS based service and the TSO costs are recovered from there.

15.3 In any event:

- (a) The Commission is estimating the position on a forward looking basis, and not on a static basis, as at the commencement of the regulated period of, say, 5 years.
- (b) It is unlikely that the TSO will remain linked to copper, given developments such as UFB, RBI, and the ability of mobile to service commercially non-viable customers.

15.4 The UCLFS IPP determination of 24 April 2014 appears to incorrectly link the NUCLL price with the UCLFS cost and price. As noted above, what cannot happen is that any problems arising from the UCLFS IPP are loaded onto the UCLL and UBA PRDs, and the Act only permits cost associated with those STDs to be recovered from the UCLL and UBA prices (a point that is made clear by cl 4B of Sch 1 of the Act).

15.5 Finally, the court decisions on TSO, especially the Supreme Court decision are relevant in a number of respects even though there are differences in the pricing methodologies and the legislation. For example, the Supreme Court decision would appear to make it necessary to consider mobile technology for the MEA, at least in more remote areas. However, the signs from the information requests made (and not made (for example. no requests of 2degrees and Telecom)) are that mobile is not being considered as an option. The Supreme Court found that to be an error of law on TSO and we cannot see any relevant distinction in relation to the PRD process.

## 16. Proposition M: UBA uplift must link to the actual UCLL copper service?

16.1 On this proposition, Chapman Tripp fall into the error that they and Chorus counsel against. They have incorrectly conflated the two separate and sequential issues:

- (a) What is the service being priced under the PRD; and
- (b) How is that service priced, including as to choice of MEA.

16.2 The service being priced under the PRD is the service as described in the UBA STD. That is, it is an all up Layer 2 service (which comprises Layer 1 and Layer 2 inputs). It is not (a) UCLL service plus (b) Layer 2 uplift. The latter split is a pricing split (that is, it arises at the second step above).

16.3 The price definition comes in only at the second step. That definition reads:

The price for Chorus's unbundled copper local loop network plus TSLRIC of additional costs incurred in providing the unbundled bitstream access service

16.4 Start with the first component of the definition: "*The price for Chorus's unbundled copper local loop network*". That price, whether IPP or FPP, is the price based on the modern equivalent asset of the service which is UCLL. That MEA, it is accepted by Chapman Tripp, does not have to be a mirror of the current service.

16.5 Thus, it is more sensible for the price of the UBA "additional costs" to be based also on a modern equivalent asset which usually but not always will be the same MEA.

16.6 The underlying copper UBA service must of course be able to interconnect with the underlying copper UCLL service. But it does not follow from that that the price of the UBA uplift must be based on a copper MEA. As a matter of economics and policy, the position is to the contrary. That is a different question from what the service functionality must be. One is a question at the first stage above and the other is for the next stage.

16.7 To do otherwise would be inconsistent with the context and purpose of the Act. The Act should be interpreted to fulfil the broader purpose, which is an interpretation that is readily available. The TSLRIC construct pivots around the modern equivalent asset concept in arriving at the price. The MEA as a matter of economics and policy is not constrained by the underlying technology: the position is completely to the contrary of that. To interpret the Act in the manner postulated by Chapman Tripp would be to unnecessarily restrain the appropriate application of the Act.

16.8 No complex or strained interpretation of the Act is required to get to the conclusion that we have outlined above.

16.9 There is a further point. The Act does not require the Commission to take the existing UCLL price (whether IPP or FPP) and then add to that the "additional costs".

16.10 If that was required, the Act would have said so (for example by saying something like: "*The price determined for UCLL plus additional costs...*"). But the definition instead starts with "*The price for Chorus's unbundled copper local loop network...*". For example, this does not include, contrary to the UCLL service definition, the word service: it talks only of the network.

16.11 To meet the requirements of the price definition, it is not necessary to separately calculate the Layer 1 and Layer 2 components. That can be an unnecessary



complication, given the same outcome may be reached simply by doing the one calculation. Given that the UCLL service as in Sch 1 in fact is being modelled and priced, doing this is a relatively simple step in this instance. On other occasions, such as where only UBA is being priced, the Commission may simply take the existing IPP or FPP price.

16.12 However, even there, the Commission can, and perhaps should, do the modelling of the Layer 1 component to produce a fully updated price. In this instance that is not required.

16.13 In summary, the Act should enable an outcome that is consistent with the broader policy and economic objectives of TSLRIC. Therefore the UBA uplift MEA should not be constrained to a hypothetical network that works only with a copper network.

## **17. Proposition N: can UBA (and UCLL) be de-averaged, other than geographically?**

17.1 For the reasons outlined at Para 6 of the Orcon/CallPlus submissions<sup>9</sup>, UBA should have a single price, as should NUCLL and SLU have a single averaged price. In practice it is not necessary to price each service and then average. That exercise can be combined as that produces the same outcome by a quicker and valid process.

## **18. Proposition O: Relativity**

18.1 We agree with the proposition but we note that there is considerably more detail involved in any s 18 analysis, including the relativity analysis. In particular, a sufficiently complete empirical efficiencies analysis from a consumer welfare perspective – across all relevant markets - needs to be undertaken, applying the High Court Part 4 IM judgment's dicta.

## **19. Proposition P: Backdating**

19.1 We are not commenting on this proposition and it is deleted for that reason.

19.2 We turn now to timing issues

## **20. Timing**

### ***Introduction***

20.1 In this section, we outline our understanding of the legal risks of appeal and judicial review if the Commission continues on its current path. We assess this based on:

- (a) the information we have seen such as the information requests;
- (b) what a potential litigant – an RSP, Chorus and/or a consumer representative - might expect to see on discovery or an OIA request;
- (c) our experience in Commission matters over the years.

20.2 In regard to that last point, this section of our memorandum expands beyond pure legal views to more wide experience in the realities of Commission matters.

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<sup>9</sup> Which was drafted by us

- 20.3 We do not repeat the matters raised in the Orcon and CallPlus submission save to note the stark disconnection between what is happening here and other Commission processes over the years (including, even, the IPP for these services and the time leading up to the decision to fast track this PRD).
- 20.4 As Orcon and CallPlus outline, improved project management can speed up matters but nothing like what is proposed here. We query whether the focus on project management is giving the Commission its confidence on the tight timelines, in the face of such an exceptional about-turn in terms of timing, relative to history. As we know from considerable experience over many years in advising public sector clients on ICT projects, the public sector is littered with project failures and blow outs irreversibly caused by project management problems, design and scoping decisions at the outset, often based on rather optimistic assurances from vendors in RFP processes. We do not know if that has happened here, but we can see some hallmarks that overlap and therefore question if there might be unrealistic expectations set in the design process which will come back to haunt. For example, TERA say they can provide quick turnaround, and from the workshops it was apparent that this was a key reason for confidence as to the speed of the process. But that is of no use if the timelines force “garbage in- garbage out”. The information requests for example firmly imply an insufficient approach in terms of the robustness and approach required by the Act. We outline below the increasing pressure the Commission will face to cut some corners and simply accept unverified and less relevant Chorus data.
- 20.5 Our client has asked us to emphasise that it is raising this from the perspective that any disaffected party might sue, and that, in view of the information requests indicating no change of approach since the April submissions, it feels it has no choice but to raise these issues squarely, albeit it is uncomfortable in doing so.
- 20.6 On that point, reducing litigation risk is not just about reducing the risk that Chorus will sue. We think there is every prospect other parties on the wrong side of a decision would sue. Take the straight forward example of the Commission not considering mobile as a candidate MEA, an issue of concern from the perspective of RSPs and consumers. This looks to be an arguably straightforward error of law as the Commission is not applying the Supreme Court judgment. It would be parties other than Chorus taking action on that. Similarly as to our view that the MEA must be scorched earth.

### ***Our approach***

- 20.7 Any potential litigant – as at today – would need to make an assessment as to what discovery, OIA and other processes might produce. On what is available today, we think a disaffected litigant would have grounds to take court action. Of course the assessment will change one way or another as this matter proceeds.
- 20.8 An appeal is only available after the determination is made. Judicial review is usually only available after the determination is made, but there may be occasions where orders can be sought before.
- 20.9 Just as a declaratory judgment was sought on interpretation issues in the backdating Court of Appeal judgment, so might that be sought here on limited issues. But, generally, many if not most of the issues dealt with below will need to await the determination. That of course is problematic in terms of outcomes including s 18 LTBEU.
- 20.10 On the above basis, we are assessing whether a disaffected party might have grounds to litigate due to the timing, etc (and not whether in fact they would ultimately succeed, given that, today, that is dependent on seeing more information by discovery, OIA, etc.).

- 20.11 Generally, a public sector agency can start building its approach before going to consultation, so long as there is ultimately open-minded genuine consultation. Additionally, any process errors might be fixed by subsequent consultation. Thus, while the Commission appears to have landed on its MEA, at least in urban, even though consultation on the choice of MEA did not conclude until today, it may be – we don't have enough information to be sure – that the Commission can regularise the position by open-minded consultation later in the process (such as on the draft determination). However, for the reasons outlined below, it is not readily apparent that there can be genuine open-minded consultation at that stage: the timing pressure would not permit changes beyond the minimal.
- 20.12 Finally, for the purposes of judicial review, we have assumed that expert evidence would be given as to how TSLRIC pricing is carried out internationally and how the Commission's process fits with that. We have used the Commission's own experts' reports in Denmark to benchmark this, but we note that the type of approach there is consistent with other jurisdictions: therefore it is expected that an expert, such as a distinguished retired regulator, would verify this.
- 20.13 Expert evidence from overseas is highly relevant. Subject to some unique features in our Act, the TSLRIC definition is only briefly stated. Thus, the Commission and the court must look to the broader context and purpose of the legislation to deduce what the Commission must do. There, the substantial international body of experience with TSLRIC is highly relevant. If the Commission departs from the international approach it likely falls into error, unless the statute requires that approach.
- 20.14 Additionally as to Denmark:
- (a) Denmark has about the same population
  - (b) It was an IPP benchmark, further indicating parallels;
  - (c) To the extent it is suggested our size is too small, and the economic impacts are limited, the Denmark experience indicates otherwise;
  - (d) The Danish MEA model assessment and the model reference paper could be done more quickly and in less detail, as they built upon earlier work in Denmark (most recently by Analysys Mason who also produced a comprehensive model reference paper).
- 20.15 In any event, the Orcon submission indicates that, on one dimension alone, the choice between the FTTN and the FTTH MEA might produce a pricing difference (based on \$7.30 per month) of in the order of \$44M per 100,000 UBA customers (based on what appears to be the intended regulated period: 5 years<sup>10</sup>). There are other moving parts in the calculation and the example given is rudimentary. But it is difficult to fault the example, and even if the numbers change markedly, there are still strong signs that the choice of MEA, and other choices will lead to very different outcomes.
- 20.16 That implies the need for a robust approach by the Commission.
- 20.17 In this section we will focus on the adequacy of genuine open-minded consultation, and whether the consultation meets the Act's requirements. We will not deal with other potential issues such as legitimate expectation of consultation at key stages, and pre-determination (to be considered given, for example, the MEA and the detail in the model reference paper has been chosen before the MEA consultation concluded). We will also not go into detail on other matters relevant to appeals (and possibly judicial

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<sup>10</sup> The Information requests refer to 5 years.

review) such as allegations as to the Commission taking the wrong approach (eg not using the FTTH scorched earth MEA; not undertaking a quantitative cost benefit efficiencies analysis under s 18, etc).

**Current timetabling**

20.18 Timetabling includes the following:

Date	Due date
17/4	Second Information requests of Chorus and VF but not of others such as LFCs and MNOs (We are informed it was not intended to make requests of the LFCs)
30/4	Cross-submissions on the further consultation including as to choice of MEA
7/5	TERA provides draft Model Reference Paper to Commission
19/8	Commission releases draft determinations
15/9	Submissions on draft determination
29/9	Cross-submissions on draft determination
?	Conference
1/12	Determination

20.19 There are strong indications that the following facts apply, which may be confirmed on OIA or discovery request of the Commission:

- (a) The Commission has already decided upon most or all key components of its MEA, in such a way to make this probably irreversible in practice, given:
  - (i) TERA said they were only going to be able to model one MEA;
  - (ii) The MEA at the TERA workshop was scorched earth FTTH, with an option to have a scorched earth FTTH MEA from the same nodes;
  - (iii) The timetable is so tight that the Commission and TERA had no choice but to down-select the MEA some weeks ago at the latest;
  - (iv) What particularly makes this clear is that the draft MRP is to be produced on 7 May. This is, or at least should be, a complex document setting out, in draft, detailed modelling decisions. Given we have not seen a Model Assessment Paper similar to that done by TERA in Denmark, it is possible that the MRP will deal with MEA selection too. TERA’s draft MRP for Denmark for 2012-2014 is 57 pages long excluding calculations. Its predecessor, done by Chorus’s experts, Analysys Mason, for Denmark in 2010, is also lengthy and detailed.
  - (v) The Commission has unreservedly committed to issuing the final determination by 1 December by way of its media release.
  - (vi) Further, the information sought of the industry, and, tellingly, what was not sought, points to the choice of MEA and the detail of the modelling, having been narrowed down. For example, only limited information is sought on Chorus’s UFB roll-out (and that only in the second request not the first). No information is sought on the LFCs’ implementation even though they are greenfields (and therefore not constrained by legacy networks) and less expensive technology was used such as poles (thereby making this the best



source for an optimised hypothetical network). The implication is that FTTH is not to be used and that in any event, scorched earth FTTH is not to be used.

- (b) The Commission has decided upon most or all key components of its MEA before completing consultation on what the MEA should be. The further consultation squarely raises central issues as to what the MEA can and should be. But to get to the point of the draft MRP, decisions had to be made well before the close of cross-submissions, let alone the week between then and when the draft MRP is due.
- (c) The Commission will not obtain network and other information from LFCs and MNOs (other than the limited information obtained from Vodafone) despite the fact that the Supreme Court, in materially the same circumstances, found that the Commission committed an error of law by not adopting mobile as the modelled technology and there were concerns too as to the use of scorched nodes as being inappropriate for use of mobile (the same point applies to FTTH as well: exchanges and cabinets do not appear to be suitable nodes for FTTH).
- (d) The Commission will not undertake an empirically sound comparison of MEA candidates.

### ***Full empirical MEA assessment is required***

20.20 On that last point, in our view the Commission must do a robust empirical analysis of what MEA to use, similar to that done by TERA in Denmark. There is no sign that this has been done, and we expect that discovery and other requests would confirm this.

20.21 Points that indicate a full empirical MEA assessment is required by the Act include:

- (a) The sums at stake here for consumers and industry are very considerable in terms of different potential outcomes;
- (b) The PRD, following the IPP, implies a careful process;
- (c) International experience would require it: the current process is an outlier by a substantial margin;
- (d) Particularly significant is that the requirement for a detailed quantitative assessment for uplift of WACC (submitted on by Orcon in the WACC FPP consultation) would in our view apply here too. That is a natural conclusion from the IM judgment, on which Orcon submitted in the FPP WACC consultation. Putting this another way, the Commission takes unnecessary appeal and review risk if it does not undertake a sufficiently fulsome empirical MEA assessment.

### ***MEA choice only tentative?***

20.22 It is acknowledged that the Commission may have made a tentative decision that could be reversed based on submissions (or in any event could reverse the approach even if it has made a firm decision). The immediate problem with this, however, is that, given the tight time lines, any departure from the critical path will throw out the 1 December

deadline. For the first time that we are aware of, the Commission has unreservedly committed to delivering the determination by a particular date.

- 20.23 Even now, but increasingly as we get closer to 1 December, it will be exceptionally difficult to change path other than on relatively minor issues. We cannot see any practical basis on which the Commission could change its approach. Faced with making changes in response to valid submissions, or not jeopardising the 1 December delivery date, it would in reality be unlikely to change. It simply cannot do so.
- 20.24 This implies that “consultation” may be largely illusory at draft determination and conference stages. That raises issues under public law and under the Act. We expect that expert evidence would confirm how difficult it would be to change path at that stage.
- 20.25 Normally any consultation or process error might be fixed at the stage of consulting on the draft determination. But given this time pressure, it is not realistic to expect an open minded and balanced approach to submissions in September 2014. The pressure of the self-imposed time limits will likely overwhelm other factors. The time lines are self-imposed by the Commission as reasonable efforts only are required. The Commission is not required or expected to meet this deadline.
- 20.26 Normally things would work out and, as it has done before in nearly every process, the Commission would make the time. But here, decisions made by now and in the next few weeks appear to be leading to irreversibly negative outcomes. Alternatively they are leading to substantially greater delays as the Commission has to go back and start over, such as by doing a proper MEA assessment and then restarting the process with the correct MEA and the correct detail around the MEA and in the MRP.
- 20.27 In parallel, the negative issues Orcon, CallPlus and others said they expected to arise are becoming more apparent. The apparent decision not to obtain information from other LFCs is an example, but the requests overall are limited. In modelling a hypothetical network, Chorus’ network ought to be relevant only in so far as it provides useful information from which to estimate the cost of that hypothetical network (the exceptions being the location of the nodes for the scorched earth network, the network to that point, the demand assessment, and the assessment of the DSL footprint of the services).
- 20.28 The 17 April requests, including to Chorus as to UFB, were made after submissions by the parties that:
- (a) the LFC networks provide better evidence than the Chorus UFB and FTTN networks. For example:
    - (i) they are often networks over poles not via ducts, and
    - (ii) they are green fields implementations, largely independent of the need to overlay legacy networks;
  - (b) undue use of Chorus information will likely lead to incorrect outcomes, particularly higher costs (including because, as TERA noted, they could not audit the data they got from Chorus);
  - (c) the time pressure would mean undue reliance on Chorus data, thereby negatively affecting the quality of the outcomes.
- 20.29 There is the appearance that those submissions, and similar submissions by others, are not to be followed. However, it may be that the Commission –properly – is awaiting receipt of the cross-submissions before altering its path.



- 20.30 Based on our experience, we consider that the approach that has started now will only become worse. We expect that the inevitable escalating time pressures and increasing complexities will mean the Commission will simply have to accept much information from Chorus without verifying it and without getting alternative information. We expect that expert evidence will confirm that the consultation period on the draft determination cannot produce useful information from anyone but Chorus given the complexity of the task (even leaving aside the reality that by then, there is no realistic prospect of change and so consultation is illusory).
- 20.31 Like other people engaged in telecommunications regulation, we are very familiar with the reality that incumbents can and do game this information asymmetry. Therefore, as we see it, and again, as we would expect an expert to confirm, the expedited approach plays to Chorus.
- 20.32 Our analysis above raises litigation risk issues but also raises broader outcome concerns in terms of s 18 consumer welfare. It is not apparent why this expedited process is in the LTBEU.



## Appendix A. Chapman Tripp's propositions, as amended by track-change

- (A) *The Commission is a creation of statute, and its functions and powers in relation to a PRD are both provided and limited by the Act.*
- (8) *In undertaking a PRD exercise, under Part 2(4) of the Act, the Commission is required to comply with all of the provisions of the Act.*
- (C) *Insofar as the courts have analysed and opined on the purposes and provisions of the Act, ~~and especially Part 2~~, the Commission is required to ~~adhere to~~ apply those analyses and opinions in the same way that an inferior court applies superior court decisions (that is, based on the doctrine of precedent). ~~and not disregard such analyses and opinions.~~*
- (D) *Insofar as the Commission has a discretion or judgment to make under the Act, including in deciding various issues that go to making a PRD, that discretion or judgment is not unfettered but must be exercised lawfully, rationally, having regard to ~~the section 18 purpose~~, the Act as a whole, and other relevant considerations including context. This is a two-step process:*
- *Firstly, the Commission obtains and analyses the evidence on the cost/TSLRIC of the service. Section 18 has no role at this stage. Any discretion or judgment is based upon what will produce the best estimate of TSLRIC (that is, a purely cost-focussed approach).*
  - *Secondly, the Commission must "consider what s 18 tells it as to where the.. price should be set, within a plausible range for TSLRIC."<sup>11</sup>*
- (E) *While the purpose of the Act is to provide for regulation of certain designated telecommunications services, and the provisions of the Act are paramount, the avoidance of unnecessary and damaging constraints being imposed on an access provider's economic existence is a relevant consideration. However, this is a consideration if and only if that "promote[s] competition in telecommunications markets for the long-term benefit of end-users of telecommunications services" under s 18. That is solely a consumer welfare consideration. The interests of Chorus and its shareholders and investors are irrelevant. In assessing s 18 considerations, the Commission must do a sufficiently detailed empirical efficiency analysis as a matter of general rule of law factors, as well as being indirectly reflected in the Act's purpose.*

<sup>11</sup> *Chorus v Commerce Commission and Others* [2014] NZHC 690 at [176]



- (F) The structure and logic of the two-stage price determination process (using "initial" and "final" final principles) provides a statutory assumption that the PRD (using the FPP) will produce a more accurate TSLRIC-based ~~efficient~~ price for supply of the service regulated under the relevant STD. The price should be as efficient as the TSLRIC model permits. The Section 18 efficient analysis is not limited by the TSLRIC constraint including the prospect that TSLRIC produces inefficient prices.
- (G) A PRD necessarily relates to the service which is the subject of the STD, which itself may be narrower than the full Schedule 1 (Part 2, Subpart 1) service description. Other services (regulated and commercial) using the same facilities as the service being priced are relevant to establishing the price, but not as to jointly deciding the price (even though, from a practical perspective, the analysis is undertaken in parallel). The other services are relevant as to the sharing of cost over shared facilities and the sharing of common cost. The Commission must determine:
- The other services using the same paths (excluding services that do not);
  - Whether such services have elements that are incremental (and therefore separate)
  - The estimated demand for all those services;
  - The respective contributions to shared cost based on appropriate methodologies;
  - How corporate overheads and similar cost are shared (based on an EPMU approach); and must follow its own process (that is, it cannot be dealt with jointly with another PRD for a separate service).
- (H) While the service description in Schedule 1 in the Act and/or the non-price terms in the STD may be amended, that generally requires compliance with a meaningful procedure prescribed by the Act, and is irrelevant until and unless a new service description is in place. The exceptions are minor amendments to enable the PRD to be workable: s 52(d) permits minor changes for that purpose.
- (I) The TSLRIC FPP is defined in Schedule 1 (Part 1, Subpart 1) in terms of "forward-looking costs", and plainly contemplates and permits, for the purposes of pricing the service, analysis of technologies other than those actually deployed by the current access provider, **but** the definition and concept of TSLRIC cannot dictate the description or scope of the "service" to which the PRD will apply except for minor changes under s 52(d). The question as to what is the "service" to which the PRD applies is a different question from the separate and subsequent question: How that service to be priced (including as to what the MEA should be and how it should applied). To ensure that the service is priced upon a MEA ~~modern equivalent asset~~, and not



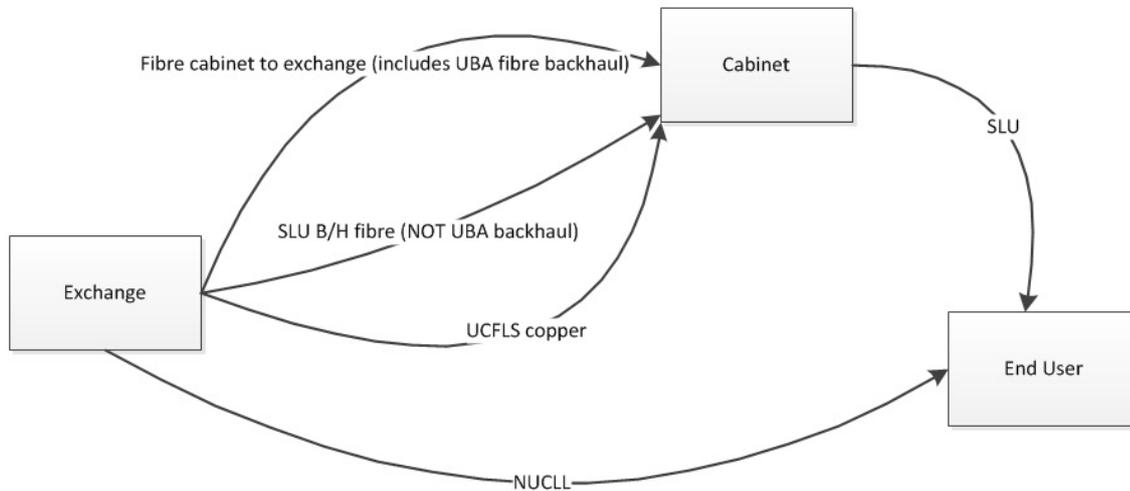
- constrained to the same legacy technology, the MEA may not include all the functionality of the underlying service. In any event, a FTTH MEA has the same functionality for UBA and UCLL.
- (J) Part of the context in which the Act and the STDs are interpreted is that~~The Act reflects a legislative intent or expectation that~~, at the time of a PRD, access seekers would already be utilising the designated access service as defined in the Schedule 1 service description and the STD, and have reflected and relied on aspects of the functionality of that (described) service in their own (retail) services.
- ~~K) Conversely, while there may well be some "abstraction" of service functionality involved in a TSLRIC analysis, it cannot have been a legislative intent that the service to be the subject of the PRD exercise would be one which (in the relevant hypothesis) was inconsistent with, or assumed away, such functionality.~~
- (L) The provisions of the Act relating to the TSO (in Part 3) are directed to quite different concepts than Part 2, and have no direct relevance to the PRD analyses. ~~However, as an indirect matter of relevance, it would be inconsistent with an overall legislative intent or expectation if the PRD analysis involved assumptions about technology which were inconsistent with, or assumed away, In particular,~~ the ability of service providers to comply with the TSO is irrelevant. The Court's judgments on the TSO process are indirectly relevant to the PRD processes.
- (M) The UBA FPP requires the Commission to consider the "additional costs" of the UBA service - that is, additional to the price of Chorus' unbundled copper local loop network. However, that does not require the MEA to be a service that can interconnect with the copper UCLL network. The MEA must be unconstrained by the underlying copper-based requirements. The forward looking additional costs must therefore be based on technologies not only capable of delivering the (already defined) facilities and functions of the service, but also capable of interconnection with Chorus' copper local loop network such that the "additional costs" of that service to, and over, that network may be identified.
- (N) To the extent that the "additional costs" of the UBA service may vary depending on the characteristics (other than geographic) of Chorus' copper unbundled local loop network over which it is provided, the Commission ~~cannot~~may (but is not required) to set multiple price points for the UBA service. The Commission must also average the NUCLL and SLU prices
- (O) The Commission is required, when exercising any necessary judgement in the determination of the TSLRIC of the "service"



for services within the UCLL and UBA service descriptions in Schedule 1 by reference to section 18 of the Act, to have regard to relativity (encompassing the "build/buy" concept) between the UCLL and UBA services.

~~(P) At least in the absence of some truly extraordinary countervailing considerations, any PRD must operate retrospectively, substituting for the (statutorily assumed) less efficient initial price in the STD – regardless of whether the PRD involves an increased or decreased price for the services.~~

## Appendix B. Glossary



**FCE:** fibre cabinet to exchange. This is a new definition we are proposing to clearly delineate the SLU backhaul regulated service (which is provided over FCE) from other services provided over FCE: for example, FCE not SLU backhaul is an input into the UBA service.

**FUCLL:** the full copper local loop, namely the UCLL footprint plus the copper backhaul from the cabinet to the exchange. UCLFS is provided over FUCLL (and it is provided over copper beyond the footprint of the DSL-capable network such as in remote rural areas).

**NUCLL:** the determined service in the STD for end user to exchange UCLL

**SLU:** the determined service in the STD for SLU

**SLU backhaul:** this is only the regulated service used in tandem with SLU. It is not an input into UBA. This needs to be carefully separated from the following

**UCLL:** Both NUCLL and SLU. This is the designated service as defined in the Act;

**UCLL footprint:** this is made up of the copper between the end user and the exchange for non-cabinetised lines and the copper between the exchange and the cabinet in relation to cabinetised lines. It excludes the cabinet to exchange path. The footprint extends only to commercially viable DSL lines.