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Cross submissions as to draft UCLL and UBA FPP determinations

20 March 2015

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1. Introduction – proposed pricing an outlier

1.1 There are strong pointers, it is submitted, to unprecedented generosities/price uplift for Chorus in the December 2014 draft decisions:

(a) **Prices that are considerably out of kilter with international benchmarks:** Spark have benchmarked that "The Commission's draft UCLL price is 80% higher than the median price for the same service in the countries we compare ourselves against. It is 60% higher than the next most expensive country".[1]

(b) **Very high asset valuations:** The Commission has adopted "an asset valuation that is 3 times that of Chorus' actual assets and results in end-users compensating Chorus for assets they have already paid for"[2] and "has included costs in its models that were not paid for by Chorus in the past, and will not be paid by it in the future".[3]

(c) **ORC methodology produces far higher valuations:** as WIK explain,[4] "The assets actually used represent about [….] CNZRI (or even less) of

[1] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 7.
[2] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 9c.
[3] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 9d.
[4] WIK Submission 20 February 2015 at [46].

the value the Commission is attributing for the purpose of calculating the regulated UCLL and UBA prices."

(d) **High costs:** "WIK advises that: …The Commission's models overstate the efficient forward-looking costs of both UCLL and UBA by considerable margins – at least 30%-40% for UCLL and 20%-30% for UBA".[5]

(e) "WIK conclude that making adjustments to address [the] defects [it identified] would result in a UCLL TSLRIC cost in the range of $14-16 and a UBA TSLRIC uplift cost in the range of $7-$8".[6]

(f) "NWS advises that: … Even under extremely conservative restrictions, including the Commission's unbundling footprint as the boundary for FWA, proper FWA modelling results in a 37% reduction in the cost of non-urban lines in the Commission's model".[7]

(g) The Network Strategies and WIK expert reports indicate that the prices for UCLL and UBA should be $16.64 (not $28.22) and $7.83 (not $10.17).

(h) **Wealth transfers from consumers:** Spark estimate that the draft decisions "… would have the effect of transferring between $500 million and $1.5 billion dollars from New Zealand end-users to Chorus over the course of the next five years …".[8]

(i) For every $1 the UCLL and UBA prices goes up, consumers ultimately pay to Chorus an additional $100M, assuming pass-through.[9]

(j) **Low income households lose out:** Spark has estimated that the draft copper prices would lead to a decrease in broadband affordability and less use of services, conservatively estimated by them at a social cost of between $640 million to $1 billion for the regulatory period.

(k) **High excessive returns:** Vector has assessed (independently reviewed by Network Strategies) that the IPP/FPP prices would allow Chorus a ROI between 20 – 25% over the next 5 years;

(l) **Out of kilter with cross-sector precedent:** This draft decision contrasts with the Commission's decision to lower the price uplift provided for electricity and gas networks, under Part 4 of the Commerce Act, from 75th to 67th percentile WACC, which the Commission estimated would make end-users better off by $45 million per annum.[10]

(m) This begs the question just how generous the Commission is being to Chorus in comparison with electricity and gas networks and why? The Commission has not quantified the generosities, in contrast to its approach under Part 4 of the Commerce Act to applying transparent generosities through WACC uplift, but it would appear the Commission has provided Chorus with generosities well in excess of the WACC

[5] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 16a.
[6] Vodafone, SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION on PROCESS PAPER AND DRAFT PRICING REVIEW DETERMINATIONS FOR CHORUS' UNBUNDLED COPPER LOCAL LOOP AND UNBUNDLED BITSTREAM ACCESS SERVICES and COMMENTS ON ANALYSYS-MASON'S TSLRIC MODELS, 20 February 2015, paragraph vii).
[7] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 17b.
[8] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 14.

[10] Commerce Commission, Amendment to the WACC percentile, Briefing for financial market analysts, 30 October 2014.

percentiles granted for electricity and gas networks – without explanation of why Chorus should be treated more favourably than electricity and gas networks.

(n) **Generosities compounded by backdating:** The Commission has formed the preliminary view that it should backdate the price increases, even though there is no evidence this is necessary to ensure Chorus would be able to recover the costs of its past prudent and efficient investments (the High Court definition of "reasonable investor expectations"[11]).

1.2 No reasonable investor would have predicted this outcome, particularly if they were sophisticated enough to observe the Commission's "not a penny more, not a penny less" approach to removal of excessive returns in electricity and gas under Part 4 of the Commerce Act/or followed the precedent set by the High Court decisions in the Part 4 IM Merit Appeal.

1.3 It is also unclear, noting that the Commerce Commission's decision on Part 4 WACC percentile generosities revolved around incentives to invest, why these generosities would be needed when Chorus is only planning on investing $60 to $75 million on its copper network over the 2015 financial year.[12] That is what it stated last month in its 6 monthly results.

2. Summary

Legal position

2.1 There is a large number of criticisms and submissions by stakeholders, their expert economists, etc, on major and multiple issues, which alone appear to be impossible to deal with adequately by the scheduled May date for providing the draft determinations. There are also the legal issues that have been raised. Despite this, the Commission confirmed last week it will stay with its current path of issuing its statutory draft determination then, with a final determination in September.[13]

2.2 In light of that continuation, this cross-submission more clearly articulates the previously submitted errors of law and other judicially reviewable errors, for the reasons outlined in our 13 March letter, copied at Appendix B below. It would be preferable to focus more upon the substance and the merits, but the Commission's approach is of such concern from a consumer interest and welfare perspective that it seems there is little alternative but to focus on legally reviewable issues.

2.3 Emphasised is that:

(a) The legal concerns are not limited to what is outlined here (for example, there have been prior submissions raising additional issues);

(b) The intensely factual decision of the Supreme Court in the TSO judgment shows how far the courts will delve into factual issues on appeals limited to errors of law. That observation applies beyond the area of immediate impact of the judgment: valuing reusable assets at ORC, historical cost or another basis, and choice of MEA;

[11] *Wellington International Airport and others v Commerce Commission* [2013] NZHC 3289, paragraph [605].
[12] https://www.chorus.co.nz/file/58700/208446.pdf
[13] Stephen Gale briefing to the Commerce Select Committee.

(c) The overall combination of the Commission's processes may lead to legal error (whether reviewable by appeal and/or judicial review). For example:

(i) if, on its own, not holding a conference after the statutory draft determination is not in breach of the Act, that extraordinary departure from long standing Commission practice, along with other factors, may be judicially reviewable. (We have not yet researched this issue pending a reply to our 13 March 2015 letter);

(ii) it is submitted that, given the considerable volume of concerns expressed by submitters, some of which require a great deal of work by the Commission and TERA, it is not possible to adequately deal with those submissions, as legally required, before the scheduled statutory draft determination date; and

(d) It is not yet possible to submit, or it is inappropriate to submit, on multiple issues, given the absence of important evidence and detail. Much will need to await sufficiently fulsome consultation papers and the statutory draft determination.

Engaging in writing with parties' submissions

2.4 The law requires the Commission to engage in writing with parties' submissions in the statutory draft and final determinations.[14] We have outlined at Appendix A why that is so, expanding on earlier submissions on the point. There is a substantial number of submissions on which the Commission did not engage (or did not engage adequately) in its December draft determination including even as to the submission that the Commission must engage in writing with submissions.[15] The Commission incorrectly considered that its December draft is a statutory draft, and so we can deduce the Commission's then views on giving reasons. The Commission will need to sufficiently engage in writing with parties' submissions in the forthcoming statutory draft and final determinations.

2.5 A benefit of doing so is one articulated by the judgments supporting giving reasons: engaging in writing with submissions helps the decision maker make the best decisions. That is positive for both the Commission and for stakeholders.

Application of s 18 – legal requirements

2.6 If the Commission correctly applied its legal views in the December draft determinations (and/or applied the correct legal position) few of the decisions it needs to make involve s 18 considerations, whether "predictability" or otherwise.

2.7 We reiterate this, as many of the issues raised by CEG and Professor Hausman are, in the end, not resolved under s 18. They are resolved by a direct search solely for the central estimate of cost.

Evidence based empirical analysis required

2.8 We rely on the further summary on this point in our 13 March 2015 letter at Appendix B, in addition to what we have said already.

[14] Arguably beyond that too.
[15] Which the Commission incorrectly assumed was a statutory draft determination, for which the Act requires reasons.

2.9 We note that sufficiently robust, real world, evidence based, empirical analysis is required by law on all matters for decision, and not just s 18 efficiency analysis and application. For example, decisions as to WACC, backdating, as to modelling decisions, and application of modelling choices, etc, all require evidence based empirical analysis. Despite legal obligation to do so, the Commission has never engaged in writing with multiple submissions that this is required going back to the earlier days of this FPP and to the IPP . It must do so in the forthcoming statutory draft.

2.10 Professor Hausman strongly agrees that empirical analysis as to economic factors in consumer welfare is required. Where he falls into error in applying that conclusion is that he relies largely on "academic research" based on experience off shore, and not upon the actual facts in New Zealand. They are markedly different. For example, Chorus is contractually committed to roll out UFB and needs no investment incentive now to fulfil its contract, a fact that the Professor only identifies in a buried footnote, in contrast with the approach in the body of his report. If he elevated his footnote to the body of his report, it would be markedly different.

2.11 In this submission, we have commented on the observations of Professor Hausman and CEG. For example, like Professor Vogelsang, Professor Hausman also engages in an impressionistic approach, without the empirical analysis he otherwise insists is required. He talks of the need for an uplift of the price without having any quantified (or other) idea of where the base price is relative to where an uplift should land.

2.12 The High Court in the IM judgment in any event dismissed the Hausman (and CEG) view that increased prices will be reflected in increased investment: the two are not necessarily related in that way.

2.13 In any event, in the real world analysis, key will be to define carefully which particular type of investment is involved, such as copper, fibre, investment within and beyond the UFB contracted commitments, investment by providers other than Chorus, etc. As our critique of the Hausman and CEG submissions shows, there is insufficient clarity on this.

Onus is on Chorus to show the position on an evidence based empirical basis

2.14 We show why it is Chorus which must legally show why, for example, an uplift is appropriate. It has not done so and, therefore, there should be no uplifts, etc.

2.15 The submissions on behalf of Chorus are high level and impressionistic.

Section 18 analysis to be a real world not hypothetical analysis

2.16 CEG are correct in concluding that, while deriving the price is hypothetical (that is, based on the costs of the HEO), the s 18 consumer welfare analysis is a real world analysis. They are two different steps.

2.17 We summarise the position as:

(a) The Commission derives the costs of the HEO, calling on s 18 analysis only when an impasse is reached (ie there is more than one candidate for the central estimate of actual costs of the HEO at a particular point in the decision making path);

(b) If s 18 is to be used, that is not a hypothetical analysis. It is a real world analysis, based on actual evidence, of actual consumer welfare impacts. As CEG point out there is nothing inconsistent with a hypothetical exercise followed by a real world exercise, done to arrive at a different decision (namely, consumer welfare, as opposed to the cost of an HEO's network).

CEG however don't apply the real world

2.18 It is clear though that CEG then proceeds to do some s 18 analysis based on the hypothetical position instead of the real world position. We show why that is so. In this way, we also demonstrate why, in practice, a real world and careful analysis is important.

Migration from copper to fibre

2.19 The relatively one dimensional approach by CEG and by the Commission implies that a higher copper price encourages migration from copper to fibre (that, it is said, enhances consumer welfare even though consumers pay more).

2.20 Full account however is not taken of factors such as:

(a) Consumers outside the UFB footprint never get that service;

(b) Many consumers within the footprint either will not get it until well into the 5 year period or will not value UFB's superior performance eg their speed and reliability needs are low;

(c) As Spark note, high price comes at the considerable cost of excluding lower income households and reducing usage. That is an externality they measure, on an initial basis, at a consumer welfare cost between $640 million and $1 billion. Yet CEG (and the Commission) only have an unquantified focus on a different and positive externality: the benefits of migration to fibre.

2.21 Particularly significant however are non-price issues, illustrated by academic conclusions noted by Professor Hausman, that US consumers will pay an additional US$17.60 per month for 10 Mb/s higher speed.

2.22 If that applies to NZ consumers they will be prepared to pay substantially more for fibre services than for copper services. Price is less of a factor.

2.23 In any event, the argument that high copper prices drive migration to fibre are flawed:

(a) For the reasons we identify, and as copper is a competitive constraint on fibre, fibre prices will rise and fall in tandem with copper prices (and so a higher price will make little or no difference to migration). This point is well illustrated by Vodafone increasing its fibre retail prices in tandem with copper retail prices.

(b) High retail prices encourage Chorus to keep customers on copper thereby eroding migration to fibre eg; Chorus would not expedite its UFB roll out plans ahead of its contracted minimum dates for roll out.[16]

[16] This was a point made in multiple submissions to the MBIE Telecommunications Act review consultation.

Chorus submission as to s 18

2.24 Chorus maintains[17] that all external experts agree the risks of setting an inefficiently low price outweigh the risks of doing the opposite.

2.25 We do not understand that to be so. But in any event there is some key detail. The issue of setting the price too high or too low is to be decided, as CEG agree, in a real world context and not in a hypothetical world.

2.26 It is likely that a **real world,** evidence based, empirical analysis would confirm that the hypothetical price does not need uplift to avoid the risk of under-estimation. Chorus still recovers considerable super-profits.

2.27 The Commission has not carefully separated the hypothetical exercise from the real world exercise. It is submitted that there needs to be clear acknowledgement in the process that there are these two separate steps.

2.28 In particular, TSLRIC, especially as to sunset networks and also where ORC for reusable assets is used, overcompensates the provider,beyond what is "efficient". It is not necessary to uplift the hypothetical price to avoid the risk of under-estimation. A careful **real world,** evidence based, empirical analysis would make this clear.

Competition and not investment is the objective

2.29 When applying s 18, the Commission's role is to promote competition for the LTBEU. It is not to promote investment per se, nor to promote investment by Chorus which is not in a competitive environment, yet Chorus submissions, submissions on its behalf, investor submissions, and the Commission's draft

Experts should sign High Court Expert Witness code now

2.30 The advocacy style of approach by Chorus' experts demonstrates why there is considerable value in having experts commit now to the expert witness code, in terms of making the Commission's and the parties' work more robust, quicker, more efficient and better meet s 18 objectives. The Commission has not yet dealt with earlier submissions on this, and is asked to require experts to sign the code before the next round of submissions (and before the conference) so that the obligation is not just limited, as it has been in the past, to the conference. If experts choose not to sign, that affects the weight of evidence.

2.31 In this, we are advocates not experts that would sign the code.

FWA as part of the UCLL

2.32 We outline why FWA would incorrectly be limited to the RBI footprint and why it is available as a MEA (for UCLL and for UBA) even though there is no Layer 1.

Aggregation and related issues

2.33 WIK report that the aggregated approach leads to errors including the cost of fibre backhaul from cabinet to exchange being included in the UCLL price, when both NUCLL and SLU do not have that network component.

[17] At [5] of its February 2015 submission.

2.34 This fundamental and simpler error points to errors in both the aggregated approach as described in the December draft determination (which remains difficult to understand) and to errors in implementing the approach. This has emerged from the WIK report.

2.35 Under the Act, the Commission cannot apply such an aggregated approach it is submitted. It is possible – and necessary - to price NUCLL, SLU and UBA separately in the normal way and it is not necessary to reverse engineer via an SLUBH approach.

2.36 This also raises issues as to:

(a) How costs are shared between services;

(b) Incorrect inclusion of core network costs, outside the UCLL and UBA services, and costs beyond the DSL footprint; and

(c) UCLFS.

GPON v Point to Point – legal framework

2.37 The statutory framework envisages unbundling of GPON. So does Chorus's contractual commitments to CFH. And so do Analysys Mason in a report to Ofcom.

2.38 GPON is a proper MEA candidate and it would be strange if it was not used instead of P2P, given it is cheaper and given it is what has been installed in the real world.

EUBA pricing must be based on cost – legal issue

2.39 EUBA must be cost based, and that cost can be derived, as any appropriate model would do. The fact that does not fall out of the TERA model is the problem of the model, and legally it can and should be fixed.

2.40 A gradient approach is not available, the more so as it simply replicates the IPP benchmark: the FPP is all about getting away from benchmarks and moving to TSLRIC cost.

Constant demand assumptions

2.41 Demand is increasing and that should be reflected in the modelling.

Lead ins

2.42 There is agreement with the Spark submissions.

Demand and use of available infrastructure

2.43 All demand incuding over LFCs is correctly included. The Commission has not yet engaged in writing with our submission as to sharing access to LFC and Chorus UFB intrastructure and the counterfactual approach.

Future proofing UBA

2.44 There is alignment with issues raised by Chorus, future proofing being a key part of our submissions, including via the s 30R review. This needs to be costed carefully.

Backdating

2.45 Chorus justifies requiring RSPs to make backdated payments as they can predict Commission decisions and provision accordingly.

2.46 Even though Chorus has far better information than RSPs on which to predict, given this is its network, it does not hold itself to the same standards it expects of its customers. According to what it told the stock exchange when the final UCLL FPP and draft IPP were released, the situation was so dire and unpredictable that it *"could require Chorus to fundamentally rethink its business model, capital structure and approach to dividends."*

2.47 If Chorus cannot predict and provision, no RSP could reasonably be expected to either. That underpins the chilling effect and poor consumer welfare outcomes of backdating. The uncertainties will create substantial difficulties as to investment decisions and that is a negative chilling effect for consumer welfare.

2.48 But it doesn't come to that. The Court of Appeal decision on backdating is not a binding precedent, and the Commission can and should depart from it in these new circumstances including a markedly changed Act and valuable English Court of Appeal authority. (In any event, Chorus can only get paid for backdating up to 100 days before the final decision.)

2.49 The Commission has the opportunity to step in and end backdating once and for all, and thereby eliminate its chilling effect and negative consumer welfare outcomes. We submit that setting the right precedent is very important and there is ample ground to do so, including that the Commission is not bound by the Court of Appeal judgment. This is not an adventurous step to take: it is an entirely mainstream application of statutory interpretation.

Earlier submissions

2.50 All submissions by us and our clients in this FPP process remain relevant: for example, we have not responded to App A in the Chorus submissions, as to functionality of the UCLL and SLU services.

2.51 This includes our submissions on the s 30R review which are submissions in this process too.

3. Application of s 18 – legal requirements

3.1 Before dealing with the submissions on behalf of Chorus as to application of s 18, we reiterate earlier submissions. As a matter of law, s 18 does not have the widespread application to the TSLRIC modelling that those submissions contend and that the December draft contends. Indeed, based on the Commission's views on the legal position outlined in its December draft, s 18, the draft applies s 18 to decision points where it is neither legally available, nor consistent with the Commission's formulation of the legal position.

3.2 In particular, most decisions on the path to deriving the TSLRIC based prices can, and must, only be made without regard to s 18 factors.

3.3 Chorus is incorrect in saying, at [3] of its February 2015 submission, that "*The Commission's task is to set TSLRIC based prices which promoted competition in the long-term benefit of end-users*". That is contrary to the Act: the Commission's task is, materially, solely to set the price based on TSLRIC cost.

As we have submitted before (eg our February submission) s 18 has only a limited role.

3.4 Adopting the Commission's words from its December draft, the decisions are mostly to be based solely on what achieves the "central estimate" of the TSLRIC. Section 18 is applied in only limited circumstances as it is irrelevant to that exercise (in fact, as we submitted, it takes cost and price away from TSLRIC and therefore distorts).

3.5 We have however responded to the points made by Professor Hausman and CEG, as though that is not so, because there are a small number of decisions where s 18 efficiencies analysis is relevant and therefore the position needs to be assessed.

3.6 If the Commission continues down its current path (eg by its approach to s 18 including as to predictability) it is submitted that is an error of law. There are multiple examples of this, some of which we listed at [7.11] - [7.16] of our submission on the December draft, namely the incorrect application of s 18 and predictability to:

(a) choice of ORC for reusable assets;

(b) rejecting capacity-based adjustments to the fibre MEA;

(c) MEA adjustment based on consumer preference and technological performance; and

(d) choice of modified scorched node versus scorched earth.

Draft decisions are not a central estimate:

3.7 Other submitters agree with our February 2015 submission that the draft decisions are not a "central" or mid-point estimate of TSLRIC. (We added also that the draft decisions incorrectly treated each decision point as one based on a central estimate when in fact it was not, thereby leading to overlapping and double recovery, including if there is a wash up uplift at the end.)

3.8 Network Strategies' expert report, for example, states that *"Our review of the Commission's key model assumptions indicates that the calculated point estimates in fact approach an upper bound".*[18] A similar inference can be taken from the WIK report given the sheer volume of issues they have identified where the modelling is biased upwards.

3.9 Likewise, Vodafone comment that *"The models and determinations reflect a series of decisions and assumptions that each independently tilt the Commission's calculations of UCLL and UBA upwards. The cumulative effect of these individual upward tilts is further amplified when considered collectively. As a result, the Commission has produced UCLL and UBA prices that are at odds with the Act and, as a result, do not reflect a central estimate of the true TSLRIC cost"*[19] *and "At each point where application of the TSLRIC methodology has*

[18] 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.

[19] Vodafone, SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION on PROCESS PAPER AND DRAFT PRICING REVIEW DETERMINATIONS FOR CHORUS' UNBUNDLED COPPER LOCAL LOOP AND UNBUNDLED BITSTREAM ACCESS SERVICES and COMMENTS ON ANALYSYS-MASON'S TSLRIC MODELS, 20 February 2015, paragraph iii).

required the Commission to make a modelling choice, it has made a selection that operates in favour of the access provider".[20]

3.10 Ultimately, however, we submit that the great majority of modelling and implementation decisions can only be made solely based on seeking the central estimate, and s 18 analysis has no part. This is one reason why clearly delineating the two steps, as submitted most recently in our February submission, is valuable: it enables focus in the first step at each decision point on achieving the "central estimate" of TSLRIC (which is not a s 18 issue). This avoids distortions away from the "central estimate". Then, if an impasse is reached, such as an assessment required out of a distribution/plausible range, s 18 is employed in the second step to resolve the impasse. As noted in the next section, that requires evidence based empirical analysis.

4. Competition and not investment is the objective

4.1 When applying s 18, the Commission's role is to promote competition for the LTBEU. It is not to promote investment per se, yet Chorus submissions, submissions on its behalf, investor submissions, and the Commission's draft determination are focussed on investment, mainly or exclusively.

4.2 Investment may be a factor in this assessment, but it does not dominate the strong competition objective under s 18. Section 18 is about promoting competition and, so far as investment is relevant, it is about investment that flows from competition.

4.3 Encouraging investment by Chorus, which largely is not in a competitive environment, is not a purpose of s 18 and the Commission errs by taking a different approach.

4.4 There must also be clarity about what sort of investment as we identify below. Incentives for investors to invest in Chorus are a long way removed from investments in new and valued services, for example (and the interests of such share holders is not the focus of even s 18(2A) as that is about investors in new services and not investors in those investors).

5. Evidence-based empirical analysis legally required

5.1 We also note that the points we make below are subject to the key submission, that there must be an evidence based empirical analysis. As we further submit below, in agreement with CEG, this is a real world analysis.

5.2 The Vogelsang, CEG, Hausman submissions and the Commission draft views do not undertake that analysis. This requirement, set out in Appendix B below and in earlier submissions, is summarised in what the Commission itself says it does in telecommunications matters (which it is not doing here):[21]

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

[20] Vodafone, SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION on PROCESS PAPER AND DRAFT PRICING REVIEW DETERMINATIONS FOR CHORUS' UNBUNDLED COPPER LOCAL LOOP AND UNBUNDLED BITSTREAM ACCESS SERVICES and COMMENTS ON ANALYSYS-MASON'S TSLRIC MODELS, 20 February 2015, paragraph B2.19.

[21] Commerce Commission, Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network - FINAL REPORT, December 2003, paragraph 75. (Quoted at [6.10] of our 20 February 2015 submission on the December 2015 draft determinations.

> nature, which are not readily measured in monetary terms, must also be assessed.

6. The position where empirical data is not available

6.1 As we explained at [6.21] and [6.22] of our 20 February 2015 submission, in dealing with Professor Vogelsang's approach to assessing externalities, to the extent that factors cannot be empirically evaluated, they must nonetheless be included in the assessment. That is what the Commission says of its own role in the quote above. Additionally, as to issues where empirical assessment is possible, that must be undertaken: this also is confirmed in the quote above.

6.2 Some academic research identified by Professor Hausman in his report (at [11]) shows that, even as to externalities, there will often be valuable empirical data that is available. Professor Vogelsang was addressing the lack of empirical data as to network externality effects of a UCLL price increase for UFB subscribers relative to the negative externalities on copper based services. The research to which Professor Hausman refers shows there can be relevant empirical material.

6.3 We note, moreover, that we do not accept Professor Vogelsang's view that WIK have conceded that quantitative analysis is not possible as to such externalities. Having reviewed the WIK submissions, we see nowhere where this concession has been made.

6.4 Therefore, the Commission should be cautious before concluding that, on certain issues, quantified analysis is not possible.

7. Lack of sufficiently empirical approach by Chorus is fatal

7.1 As we further explain in Appendix C, Chorus has not produced a sufficient evidence-based empirical basis for the outcomes it seeks such as in relation to uplifts and the application of s 18, and it has an obligation to do so.

7.2 The onus is on Chorus to produce this. Where it has not done so, its arguments must fail.

8. Professor Hausman

Advocate not independent expert

8.1 In the body of his report, Professor Hausman strongly submits that consumer welfare is enhanced by investment incentives arising out of higher copper prices. For example, he says, at [37] (highlighting added):

> The Commission… has chosen not to apply an uplift (risk premium) although it has modelled FTTH-based TSLRIC price for UCLL. Therefore, it has created negative investment incentives for **any current** or future FTTH investment.

8.2 Remarkably, he has buried a key fact – and probably the most important fact – in the footnote to that statement. That fact is that Chorus is contractually committed to roll out UFB, which considerably impacts the conclusions in the body of his report, as new investment incentives such as increased pricing are not required as there is already committed investment.

8.3 The footnote states:

> While much of the FTTH build is under contract, if the investment incentives are distorted, further improvement in speed or capacity of the FTTH infrastructure will not be undertaken. In the US Verizon has upgraded it FTTH network in terms of both speed and capacity due to increased consumer demand and the growth in demand for streaming video, e.g. Netflix.

8.4 Burying this key information in a footnote, in a manner contrary to the overall body of the report dealing more generally with investment incentives, is the work of an advocate and not the work of an independent expert. Professor Hausman expressly knows that Chorus needs no investment incentive by increased prices as to the current UFB programme as, in his words, *"much of the FTTH build is under contract".* (This is an illustration of the value of requiring experts to sign up to the High Court code for expert witnesses, dealt with below.)

8.5 Expanding on this:

(a) It is right that, in his words in the footnote, *"if the investment incentives are distorted, further improvement in speed or capacity of the FTTH infrastructure will not be undertaken."* Here of course he is referring to improvements beyond what Chorus has contracted to do. There may be such possible improvements (such as extending the FTTH footprint voluntarily, increasing speed and capacity as in his footnote, and so on). Also, as he identifies in the body of his report, there may be other improvements for which investment incentives remain relevant, such as improving the copper based UBA and UCLL services. CEG also identify the possibility of Chorus expediting its contracted roll out of UFB.

(b) However, those possible improvements are far narrower and far less expensive than the UFB roll out, already contracted, and raise far less justification for upward biasing of the UCLL and UBA prices.

(c) Chorus, as pointed out in various submissions, will have less incentive to roll-out fibre faster than it is contractually obliged to if the Commission's copper price determinations artificially increase the profitability of Chorus' copper business.

(d) Therefore, there is little if any justification for an uplift.

(e) In the end, however, those narrower potential improvements, and the related need for investment incentives, are to be resolved by adequate evidence based empirical analysis, so that consumer welfare benefits of higher prices are clearly demonstrated.

(f) We can demonstrate this by reference to one of Professor Hausman's key points: that consumers want high reliability on their copper services and Chorus needs to have incentives to invest accordingly:

(i) As to incentives to improve the reliability of the copper based service, key will be what Chorus must deliver as part of the STDs. If, as we submit, the service must be future proofed (eg by adding additional fibre backhaul capacity up to the FDS as needed), the UBA price will already include the necessary payment and investment incentives are not needed.

(ii) If on the other hand, the STD limits what Chorus must provide, such as in relation to backhaul, to be factored in is the ability of Chorus to provide this, either commercially, or under STD variation.

(iii) All that is a matter of careful evidence based analysis, a point to which we now turn.

Professor Hausman agrees there must be careful evidence based analysis

8.6 Professor Hausman is firmly and repeatedly critical of Professor Vogelsang for not undertaking an empirical analysis. He describes the latter's single dimensional and impressionistic approach as "hand waving".[22]

8.7 For example, Professor Hausman says at [66] and [67] (highlighting added):

> **Since Prof. Vogelsang does no empirical analysis, his conclusion has no support.** Instead, he has presented a view that only looks at one factor which might move TSLRIC in one direction while ignoring factors that would move it in the other direction. His claim of "substantial profits" is also unsupported …
>
> … **Thus, Prof. Vogelsang has done no balancing of the economics factors which need to be taken into account when evaluating the outcome of TSLRIC estimation.**

8.8 Professor Hausman is right in this, the more so as the law requires evidence based empirical analysis, which, for s 18 analysis, requires empirical balancing of efficiencies. Analysis by Professor Vogelsang and the Commission falls well short of that, and the Commission has also not, contrary to its legal obligations:

(a) addressed in writing submissions as to its obligation to undertake such evidence based empirical analysis;

(b) undertaken that analysis in any event.

8.9 Having noted that, it is fully expected that proper analysis will show quantitatively that Professor Vogelsang is broadly correct in his conclusion even though the method of getting there needs to be remedied.

Analysis and evidence error by Professor Hausman

8.10 But, having rightly concluded there must be empirical analysis, Professor Hausman falls into a similar trap to Professor Vogelsang, by relying primarily on "academic research" only, largely based, where based at all, on experience outside New Zealand, in the US and Europe. For example, he concludes in his report (highlighting added):

> I note that Prof. Vogelsang has made no empirical estimate which justifies his position. He points to a single factor and states that since, in his opinion, it has been omitted, the asymmetric risk is taken care of. To properly consider this argument, one would need to make an estimate of how much price would be inflated by this factor and compare it **estimates in the academic literature** of consumer welfare gains from new or quality improved services.[23]

[22] See eg Professor Hausman at [59] and [67].
[23] At [47].

> I find that the [economic factors] tradeoff is in favor of new and improved quality services **based on academic research**.[24]

8.11 Such academic research, and other experience from overseas, can help inform the Commission in coming to its decision, and indeed can be valuable, but only if it is carefully applied. For example:

(a) His so called academic evidence draws a very long bow, generally to the point of near irrelevance;

(b) it is surprising that Professor Hausman can find so much support for his theory on the downward biasing of TSLRIC methodology and negative distortions on investment[25] (he says for example, at [53] that *"Academic analysis has demonstrated that TSLRIC regulation distorts investment incentive and leads to too little investment"*) when there is such strong criticism of the model internationally (including as to ORC rather than historical cost modelling), particularly as to producing super profits for sunset networks. This has led to widespread departure by regulators and legislators from TSLRIC (and changing of the model such as in relation to reusable assets) to more suitable pricing models. As an example of this, there is the decision of the Australian Competion Tribunal in *Re Telstra*, a decision relied on by the IM Court and by the Supreme Court in its TSO judgment.

8.12 But those academic writings and international experience are no substitute for the required actual empirical analysis based on actual evidence, of the actual position in New Zealand.

8.13 Examples of why that is so abound, but an obvious one is the point that Professor Hausman buried in a footnote in his report: that Chorus is contractually committed to roll out UFB. It is remarkable that Professor Hausman can advocate for his approach based on academic research and experience overseas, when he is well aware of this key and contrary fact, which he buried in a footnote.

8.14 Simply put, New Zealand is unique for many reasons, and overseas experience does not fully map to New Zealand conditions. There is nothing new or surprising in that.

Some further comments on Professor Hausman's observations

8.15 We emphasise, as we did at X above, that our comments under the following sub-headings are only pointers within the required more detailed evidence based empirical analysis. There are many other factors too.

Remarkable that Professor Hausman feels able to draw his pricing conclusions

8.16 Professor Hausman knows of the need to balance the economic factors by empirical analysis. As we quoted above, he said so:

> Since Prof. Vogelsang does no empirical analysis, his conclusion has no support. … Thus, Prof. Vogelsang has done no balancing of the

[24] At [68].
[25] See eg Prof Hausman at [68].

> economics factors which need to be taken into account when evaluating the outcome of TSLRIC estimation.

8.17 But Professor Hausman has no idea of what degree of uplift, or not, and empirical balancing of economic factors, there actually is in the draft determination, for it has the lack of detail and analysis for which he criticises Professor Vogelsang. Professor Hausman has no idea of what the size of the uplift is in the draft decision, or what uplift, if any, is needed in the interests of consumer welfare. He does not know if any need for an uplift has already been met.

8.18 In his words, he is "hand waving" instead of implementing what he says is required. Betraying his bias, he just says that the price must go up. His professed support for empirically making that decision is simply ignored.

8.19 This again demonstrates why experts should be required to sign the code for expert witnesses.

IM judgment disagrees with Professor Hausman (and CEG) as to investment incentives

8.20 In any event, there would be legal difficulties in applying the Hausman (and CEG) view that greater revenues from higher prices on past investments would provide funds for future investment. Even if that was not a legal issue, the High Court has a contrary view (at [1480]):

> The idea that greater revenues produced by higher allowed earnings on past investments (ie on the initial RAB) provide the wherewithal for more future investment is contrary to rational investment choice. Those existing higher earnings, once earned, are a given. The source of funds for future investments does not influence the riskiness of future investments; nor, therefore, does it influence their attractiveness. If anything, an abundance of capital is likely to lead to wasteful investment.

8.21 Even if we assume that the Hausman point is legally possible, Chorus would have to demonstrate a link between higher prices and increased investment and, in turn, a link between increased investment and improved service quality (valued from an end-user perspective). But, as Spark note:[26]

> … if and when the Commission does make such an award, Chorus is very unlikely to amend its forward-looking investment programme by "subsidising" future investment plans with some or all of the backward-looking award: future investments will continue to be made on their merits. If there are any effects on investment incentives, then, they are likely to be at the edges – and they are likely to be swamped by the incentive effects of early decisions and precedents by the Commission not to backdate decisions (whether in their favour or not) except in exceptional circumstances.

Consumers migrate to fibre largely due to quality of service superiority not price

8.22 At [11] Professor Hausman reports (footnotes omitted):

[26] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 103.

> Recently, A. Nevo et. al. (2013) estimated that consumers' willingness to pay in the US for a 10 megabit increase in internet speed averages US$17.60 per month. On a yearly basis this amount is US$212 per year. With approximately 84.3 million broadband internet users in the US the total amount is US$17.8 billion per year. Almost all of this amount is a gain in consumer welfare.

8.23 This is a valuable conclusion, applied to New Zealand, but not for the reasons that Professor Hausman puts forward (namely that increasing prices will in turn lead to a gain in consumer welfare). That is because:

(a) If NZ consumers are prepared to pay materially more for speeds higher by 10Mb/s, like US consumers, they will pay materially more for higher UFB speeds. By this we mean (a) higher relative to copper based speeds and (b) higher relative to slower UFB product offerings, so that consumers will both migrate to fibre from copper and also move up the price/quality path over fibre).

(b) This highlights the point that NZ consumers will migrate to UFB away from copper even if the copper prices are materially lower. It is the quality of service that drives this not the price. Therefore, increasing copper prices will be a significantly less relevant factor in terms of consumer welfare enhancing migration to UFB than the relative quality of service (and consumers will pay more to take faster UFB services). This will increase over the regulatory period as there is greater demand for the likes of Netflix (and predicted market changes are to be factored into the model. (In fact, as we explain when dealing with the CEG report, whether the copper price is higher or lower is at best neutral but, more likely, a higher price will reduce not increase migration to fibre).

(c) While this US research provides a strong and important pointer to the position in NZ, the key point is that it shows that the empirical analysis involves much more than, in this instance, simple price comparison between UFB and copper based services. That is an error into which the Commission has fallen, it is submitted, on both the IPP and the FPP, despite submissions to the contrary (with which there has not been written engagement). It is critical to take account of broader facts such as comparable quality of service.

(d) There is evidence in New Zealand showing that the US research applies here too: consumers have demonstrated that they will pay more for faster VDSL based services than they pay for ADSL based services.

Network congestion and internet outages

8.24 Professor Hausman rightly observes at [18] that:

> … a reduction in congestion and a reduction in internet outages are also important factors in quality …. Network outages and congestion significantly degrade internet performance. While the consumer value of less congestion has not been quantified, less congestion of the internet is highly valued by consumers ….

8.25 But he cannot correctly conclude from that, as he does at [19] (see also [64]) that:

> I conclude that the costs of network congestion and degraded quality of service to consumers as a result of under-estimating WACC or the TSLRIC price are significantly greater than the costs to consumers of over-estimating WACC or the TSLRIC price and having somewhat higher prices…

8.26 As outlined above, as to copper based services, this will depend upon the STD and how it provides for congestion issues to be handled (congestion over the fibre backhaul network being a key focus of the FPP debate). As to UFB, the service is contracted for anyway, and the point is irrelevant to that extent. In any event, the contracted UFB service greatly exceeds maximum needs for well past the 5 year regulatory period being priced.

Legacy copper versus new and innovative services

8.27 Both Professor Hausman and CEG also fail to recognise the distinction between investment in legacy copper assets and new and innovative services, and fundamental New Zealand specific factors.

8.28 It is not credible, for example, to cite evidence of the costs of delay of introduction of an entire service in the US, as Professor Hausman does, as evidence of the value of investment in an existing copper based service. Professor Hausman quotes himself stating:

> J. Hausman (1997) found that regulatory delay in the introduction of mobile services in the US led to a large loss in consumer welfare. I estimated that the delay cost consumers $25 billion per year in lost consumer welfare of approximately or $100 per person in 1990s US$ or about $155 per person in current US$. Other research e.g. Goolsbee and Petrin (2004) find a very large consumer welfare gain from the introduction of satellite TV.[27]

8.29 This would only be relevant if Chorus was yet to build a copper network. The deadweight loss Professor Hausman is citing is the entire area under the demand curve, not the deadweight loss from prices being too high or low or service quality below optimum levels.

8.30 When considering incentives to invest consideration needs to be given to the value of investment in legacy, copper, assets versus fibre assets which Chorus is contractually obliged to supply. Incentives to invest are dealt with through contractual arrangements, so uplift in prices for either copper or fibre are not needed to ensure investment occurs.

8.31 Likewise, CEG and Professor Hausman raises the risk to Chorus of technological obsolescence/asset stranding e.g.:[28]

> The Commission's draft proposal does not take account of asymmetric risk arising from sunk and irreversible investments. Also, considerable risk arises from potential technological obsolescence of telecommunications infrastructure.

[27] Jerry A. Hausman, Report by Professor Jerry A. Hausman, Response to the Commerce Commission's Draft Determination on Uplift, 18 February 2015, paragraph 9.
[28] Jerry A. Hausman, Report by Professor Jerry A. Hausman, Response to the Commerce Commission's Draft Determination on Uplift, 18 February 2015, paragraph 23.

8.32 CEG and Professor Hausman fail to recognise Chorus is insulated from this risk by the Government's subsidisation of its roll-out of a fibre network. Again, fundamental New Zealand specific factors are being ignored.

8.33 As we noted in our previous submission, *"Around 75% of fibre roll-out, by UFB coverage area, is being undertaken and controlled by Chorus. To the extent migration is occurring from copper to fibre it is Chorus largely cannibalising its own market (which it was able to factor into its UFB bid). Describing this is an asymmetric risk which Chorus should be compensated for is akin to Apple arguing its iPad needs a higher return because of the risk of losing sales to the iPad Mini".*[29]

Stranded asset risk (eg due to mobile services)

8.34 It is not enough to point generically, as Professor Hausman does at, for example, [31] and [64] to the prospect of consumers moving to other platforms such as mobile, given, as he says, predicted 100 Mb/s in the next 5 years. This, if it is relevant, requires careful empirical analysis and forecasting, taking into account facts such as NZ conditions and mobile network developments, spectrum and capacity contention constraints at base stations, and that speeds such as the 100Mb/s are arriving, as he says, at the end of the regulatory period being priced. In short, the facts are critical, not generalities.

"Protection" of access seekers?

8.35 At [52] Professor Hausman states:

> The Commission "protection" of access seekers investment is misplaced (¶ 229, p. 52 [of the UCLL draft]) because access seekers investment will not lead to quality improvement (e.g. higher speeds for broadband internet or reduced network congestion) for consumers. Thus, the Commission is "protecting access seekers" and is failing to take into account the interests of consumers under the LTBE standard. As I discussed above, the commission is required under s 18(2A) of the Act to consider the LTBE under a consumer welfare approach and not the economic welfare of access seekers. Consumers receive significantly more benefit from new and improved services than from slightly lower prices when TSLRIC is underestimated.

8.36 The page and paragraph references appear to be incorrect. But we are not aware of any such protection.

8.37 However, what is clear is that access seekers, providing, say, services over UCLL, do provide consumer welfare enhancing services. As we explain below, that is deliberately designed as part of the regulatory framework.

8.38 But, to the key point, the role of unbundlers cannot be dismissed in a few sentences, when a full evidence based empirical analysis is required, to include an analysis of their impact on consumer welfare.

[29] Wigley and Company, Submission on draft pricing review determination for UBA and UCLL services, 20 February 2015, paragraph 10.10.

9. CEG submission on Uplift Asymmetries

The CEG approach

9.1 At a high level, CEG summarise their approach in relation to both TLSRIC and WACC uplifts as follows, in their February 2015 report, *Uplift symmetries in the TSLRIC price*:[30]

> … asymmetric consequences (or asymmetric costs) stem from the fact that low prices for UCLL and UBA would:
>
> - provide weaker incentives for Chorus to continue to maintain and invest in its copper network in the long run; and
> - send signals that are likely to:
>   - impede the migration of customers from copper based services to fibre based services; and
>   - reduce the incentives for Chorus and LFCs to invest in their UFB networks.
>
> These effects could in turn affect the welfare benefits stemming from investment in fibre. We also note that the circumstances of the telecommunications industry, in which there is the potential for inter-modal competition, mean that it is not just the effect on Chorus' incentives to invest that must be considered in setting prices, but also the incentives of its competitors (or potential competitors) to invest.

9.2 The report, as with Professor Hausman, does not carefully identify and deal with:

(a) The fact that the UFB commitment is a contracted one (and therefore the relevance of fibre investment incentives apply to only small potential investments);

(b) Investment incentives as to the copper network depend on detail such as the terms of the STDs (and, therefore, again, issues as to investment incentives have a narrow compass and a narrow potential impact on consumer welfare); and

(c) The need for an evidence based empirical analysis (instead of the high level approach taken by CEG (and by Professors Hausman and Vogelsang and by the Commission in draft).

9.3 We will not deal again with those issues, focussing instead on these additional matters raised by CEG:

(a) CEG are correct that a real world not hypothetical s 18 analysis is required;

(b) CEG fails to apply its real world principle;

(c) The impact of copper prices on migration from copper to fibre; and

[30] [3] in CEG Report, Uplift symmetries in the TSLRIC price (February 2015).

(d) Price signals.

9.4 The critical caveats as to all those points continue to apply:

(a) in the end it is the comprehensive evidence based empirical analysis which is determinative, and not the indicative points set out below;

(b) for most decisions in this process, adjustment via s 18 (whether predictability based or not) would not be lawful; and

(c) CEG's treatment of WACC and TSLRIC uplifts together illustrates that considerable care is needed to avoid double counting eg WACC and TSLRIC uplifts can relate to overlapping issues.

9.5 We have not responded to all issues in the CEG submission, as, ultimately, the comprehensive analysis referred to above must be done: it is premature for us to delve into all the detail.

CEG are correct that a real world not hypothetical s 18 analysis is required

9.6 We agree entirely with CEG at [11] to [14] of their Uplift report (save that we would come to different conclusions based on their real world approach). In summary, we agree when they conclude:

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

9.7 This also fits with the requirement to undertake the evidence based quantitative analysis as to s 18 efficiency benefits and detriments, which, of necessity, is real world not hypothetical.

9.8 Therefore, in summary:

(a) The Commission derives the hypothetical costs of the HEO, calling on s 18 analysis only when an impasse is reached, ie there is more than one candidate for the central estimate of actual costs of the HEO;

(b) If s 18 is to be used, that is not a hypothetical analysis. It is a real world analysis, based on actual evidence, of actual consumer welfare impacts. As CEG point out there is nothing inconsistent with a hypothetical exercise followed by a real world exercise, done to arrive at a different decision (namely, consumer welfare, as opposed to the cost of an HEO's network).

CEG fails to apply its real world principle

9.9 At a number of points in its submission, CEG does not apply such an approach, reverting to a hypothetical approach instead of the real world. This is well illustrated two paragraphs later at [16] where CEG says (highlighting added and footnote omitted):

> Nevertheless**, if the Commission adopts the HEO as its framework for analysis of whether an uplift is required, we consider that the case for an uplift is compelling**. If the price set for the TSLRIC is below the level of **costs that would be incurred by the HEO the HEO would not invest at all**. This would be expected to be the case 50% of the time if the TSLRIC price was based on the median of the WACC and the expected level of input costs. **The welfare consequences of this would be significantly detrimental to end-users of telecommunications services in New Zealand.**

9.10 This is contrary to CEG's real world principle and wrong:

(a) It is irrelevant whether or not the **HEO** would invest if the price is too low.[31] CEG raises a **hypothetical** issue.

(b) The real world question, and the correct question according to CEG's real world approach (and ours) is: if the price derived from the HEO's service is $X (that being a hypothetical price), would **real world Chorus** invest? If Professor Vogelsang's views end up being supported by quantitative analysis, as we expect would happen, the investment decision of greatly more profitable real world Chorus is very different from the hypothetical HEO's comparable decision: the latter's position is irrelevant, contrary to CEG's point above.

(c) This is just a threshold question, on an issue that simply cannot be dispatched in CEG's four sentences above (thereby demonstrating the mixed and all too brief thinking by CEG in a way that pervades all of the submission). Other possible questions must include:

(i) Ultimately, in the real world, what is the effect on consumer welfare (as applied in terms of s 18), based on net benefits and detriments, if the price is set at $X? Only one factor in that is whether Chorus would invest at that $X price (and that one facet is more correctly framed as: to what extent does the investment promote competition for the LTBEU?);

(ii) What significance, in balancing detriments and benefits from a consumer welfare perspective, is there if Chorus would not invest? It does not necessarily follow that pricing sufficiently high to encourage investment by Chorus is to the net consumer welfare benefit eg another more efficient provider, in the real world, may better provide, in terms of price/quality, that additional service,

[31] Even if it was relevant, the approach is incorrect. This would only be valid, at best, if the TSLRIC prices were a genuine "central estimate". If the logic was correct, then we would expect to have observed 25% of electricity and gas networks regulated under Part 4 not investing at all and, following the move to 67th percentile WACC, 33% of electricity and gas networks not investing following the subsequent resets. This simply does not reflect the real world outcomes that are readily observable.

without the need for Chorus being paid more (which of course would be a static detriment to consumers);

(iii) And there are questions of detail arising out of evidence based quantitative analysis, including, for example, simple ones such as that Chorus is contractually committed to roll out UFB, and also has STD commitments as to copper.

9.11 CEG's incorrect treatment in fact ends up being a good example as to why CEG is correct in saying that the analysis as to uplift must be real world and cannot be dispatched with the sort of brief and simplistic/impressionistic statements by CEG, Professors Vogelsang and Hausman, and the Commission in draft.

Migration from copper to fibre

9.12 CEG briefly identifies some factors for and against increasing price to encourage migration. In favour of increase:

(a) Private benefits in terms of better quality and the potential for enhanced services on the fibre network;

(b) Network benefits as a greater pool of fibre customers builds;

(c) Reducing the need to maintain 2 parallel networks;

(d) Net costs of underestimating are higher than overestimating;

(e) *"..it is the relative price of fibre and copper that drives incentives for migration which will affect welfare when we consider setting TSLRIC prices for UCLL and UBA";*[32]

(f) *"Absent a concrete proposal as to how fibre prices will be set in the future, the Commission may not be able to rely on the current relativities [between copper and UFB prices] to temper its assessment of the effect on migration".*[33]

9.13 And, against increased price, that *"There will also be costs for those consumers that remain on the network – and for some there will be no opportunity to migrate to fibre".*[34]

9.14 While some of those factors are relevant, some are not. But, crucially, the same problem continues to apply as above. The analysis is impressionistic and skates over key additional facts and issues. In order to achieve optimal outcomes, there is no substitute for a real world, evidence based, empirical assessment to ascertain the degree to which the benefits and detriments are to be balanced. The following observations are on some of the factors to feed into such a detailed analysis.

9.15 We repeat the following submission as it demonstrates clearly the error in the CEG approach. Our observations below are in addition to those we made at [9.6] to [9.21] of our February 2015 submissions where we concluded, having

[32] [51] in CEG Report, Uplift symmetries in the TSLRIC price (February 2015).
[33] [52] in CEG Report, Uplift symmetries in the TSLRIC price (February 2015).
[34] [48] in CEG Report, Uplift symmetries in the TSLRIC price (February 2015).

seen Vodafone put up its fibre prices in parallel with copper price increases, in response to the backdating draft position:

> "9.17 What we have seen is end-user prices for broadband increasing. Notably, suppliers such as Vodafone have applied the increase in prices to both copper and fibre services. The impact, therefore, isn't (i) copper prices go up; (ii) fibre becomes more attractive to end-users; and (iii) there are resulting network externality and migration benefits.
>
> 9.18 Rather what we are seeing is: (i) copper prices go up; (ii) fibre prices also go up; (iii) broadband services become less attractive to consumers (resulting in lower uptake, or uptake of lower quality services e.g. copper rather than fibre); and (iv) negative network externality and migration effects.
>
> 9.19 This should not be surprising as the prices that ISPs set for different broadband services reflect differences in service quality (not simply differences in price). Thus if copper broadband prices increase then the profit maximising price for fibre services will increase (consumers who want fibre services will be willing to pay more than for copper services reflecting the superior service.
>
> 9.20 The Commission's attempt to promote migration, and network externalities, through artificially high copper prices becomes an exercise in futility.
>
> 9.21 Regardless, the impact of higher copper prices on uptake of fibre services would need to be tested empirically before it was safe for the Commission to rely on positive externality and migration efficiency arguments to determine it should provide Chorus' with an uplift in its copper prices."

9.16 Turning now to additional observations: first, on all issues above, there is a question of degree. For example, by increased prices, consumers outside the UFB footprint pay more and get nothing in return, as CEG identify. What is that cost, to feed into the analysis?

9.17 Some consumers pay more before UFB goes down their street (through much of the 5 year regulatory period given the speed of the UFB roll-out). What cost during the 5 year period?

9.18 And what of consumers who do not value faster speeds and reliability beyond copper broadband: the so called "Mom and Pop" category, and ought not pay the higher prices? What cost to them?

9.19 And what of those that can no longer afford to buy as the retail prices are too high, based on copper broadband prices, as we identified in our February 2015 submission. Spark has identified impacts at [20] onwards and Attachment D of its February submission. Particularly significant is the negative impact on lower income households should the Commission continue its narrow focus on increased prices, including as to copper to fibre migration incentives. As Spark say:

> "The resulting decrease in broadband affordability will mean less New Zealanders have access to broadband services, and New Zealanders as a whole will make less use of broadband services. Using

> conservative assumptions, we estimate the social cost of this to be between $128 million and $214 million in one year. These effects, and costs, will repeat each year for five years".[35]

9.20 And, how material, from a quantified perspective, is a price difference between copper and fibre? This is not just about direct price relativity as between copper and fibre. There are relative quality issues too. UFB provides markedly superior service ahead of copper in terms of speeds and reliability.

9.21 The paper by Nevo et al (cited by Professor Hausman and referred to above) shows that US consumers will pay an additional US$212 per year for a 10 Mb/s speed increase, implying that NZ consumers will pay substantially more for even greater speed increases available over fibre. The price differential between copper and fibre may be a relatively small factor as NZ consumers are attracted to the new service due to superior quality. That is increasingly so as new services demand higher speeds and reliability: in this real world assessment, the Commission must have regard to market conditions over the 5 years, with Netflix and the like changing demand for fibre services.

9.22 Further, as we submitted at [9.10] to [9.15] of our February submissions, setting the copper price too high could provide incentives to Chorus to retain customers on the copper network to achieve windfall gains. As we note, Chorus could choose to accelerate UFB roll out, ahead of its contracted commitments, thereby creating consumer welfare benefits, but it would only do so if the copper price is sufficiently low. Dynamic efficiencies, assessed this way, may point to net consumer welfare being enhanced by lower prices. Key here is that Chorus is contractually committed already to roll out UFB by agreed dates.

9.23 We turn now to (f) above, the suggestion that the absence of knowing how the fibre prices will be set in the future means that the Commission may not be able to rely on the current relativities to assess the effect on migration. These are somewhat surprising and difficult-to-follow observations by economists familiar with how markets work.

9.24 The position in reality is as follows:

(a) Contrary to what Professor Vogelsang says in his report, UFB prices are not regulated during the 5 year period under review here.

(b) The starting point for UFB pricing is wholesale pricing contractually agreed with Government for certain price/quality combinations. But they are only caps, and Chorus and LFCs are free to offer different and additional services so long as the cap is not exceeded. (For completeness, we note that, even if Prof. Vogelsang was right and this is a regulated service that also would be capped and would permit additional services.)

(c) Already, in response to copper pricing, Chorus and the LFCs have increased speeds for those initially agreed price points. In other words, they have increased the services' capability beyond the cap.

(d) This illustrates that:

(i) Fibre price/quality combinations will respond to market conditions;

[35] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 10b.

(ii) Copper is a competitive constraint on fibre pricing;

(iii) Wherever the UBA and UCLL price ends will drive the ultimate fibre pricing. The key point is that, on that basis, having higher or lower copper pricing is irrelevant to migration (or greatly reduced in relevance). Broadly if the copper price goes up, the fibre price would follow broadly in parallel. Thus, price increases or reductions are, broadly neutral from a migration perspective; and

(iv) Much more relevant will be the relative quality as between copper and fibre, as Professor Nevo et al's research indicates.

(e) Therefore, the consumer is getting the benefit of improved price/quality fibre services, even if the copper pricing is lower not higher.

9.25 As the passage quoted from our February submission above demonstrates, Vodafone's reaction to the backdating indication from the Commission clearly shows these conclusions playing out. Vodafone increased not only its copper-based retail prices but also, in parallel, its fibre-based retail prices.

9.26 We turn now to (c) above: the question of operating two parallel networks.

9.27 First, the Commission is legally constrained by the regulatory framework as to how it handles this aspect, as follows:

(a) As Professor Martin Cave submitted on the Ministry's legislation review, there is an argument that it is inefficient to run two parallel networks and the regulatory settings should be such that the copper is shut down as fibre runs up a street.

(b) Whatever the rights or wrongs of that view, that is not the regulatory setting under the 2011 regime that the Commission is required to apply. Parliament has made a different choice. The combination of the changes to the Act, and the UFB agreements (with withdrawal of regulation of UFB until 2019) is such that:

(i) The copper network and its regulated pricing are deliberately intended to be a competitive constraint on fibre pricing and quality; and

(ii) It is deliberately intended that the copper network continues to compete with the fibre network, but of course on the basis that over time competition from the superior network will drive away the need to have that copper network.

9.28 However, whether or not that is the legal position, pushing up the copper pricing as a mechanism for stopping the need for two parallel networks is a flawed strategy (for example, as a higher copper price may lead ultimately to reduced migration as noted above).

9.29 But, in any event, the benefits and detriments need to be quantified if and to the extent that the Commission makes s 18 adjustments.

Price signals

9.30 CEG note:

> 28. Prices serve an important function in determining incentives to invest, both for Chorus and for other businesses.
>
> 29. A price above midpoint for UCLL and UBA services signals both to Chorus and other businesses increased value in their past investments and a higher likelihood of earning a return on new investment.

9.31 Again, such high level statements are insufficient and there must instead be the evidence based empirical analysis. This must be grounded in key evidence such as:

(a) Why, and, just as importantly, to what extent, in these specific circumstances, will such "signals" lead to promoting increased competition and to what extent does that competition result in consumer welfare? That is not immediately apparent.

(b) Future investment in the copper network is likely to be minimal under any circumstances, beyond Layer 2 equipment and fibre backhaul, all of which is dealt with by the STD (or via changes to the STD). If this issue is to be pursued further, such specifics must be addressed, not just generic observations by CEG. Notably too, the correlation between an increased price and investment incentives is a decidedly blunt instrument, compared with the ability of the Commission to facilitate this directly by the STD (allowing for payment to Chorus for additional investment in say fibre backhaul) whether in the current FPP or by way of amendment later. Indeed, as we outline in this submission, there is no relationship between the two, according to the IM judgment).

(c) This is hardly, or not at all, setting a precedent for the future and/or for other businesses. Therefore, such "signals" are irrelevant. This is regulation of a sunset copper network, where the replacement technology has (a) prices set for the copper regulatory period commercially, not by regulation and (b) where Government is required by statute to review the future of the telecommunications regulatory regime (thereby removing the effect of such "signals").

(d) Those points are likely to erode the relevance of [31] to [35] of CEG's report (we have already dealt with [39] as to network congestion, on the above critique of the Hausman report).

(e) At [34] CEG give as an example its reduced incentive to invest to expand coverage of the UBA service to rural areas. As part of the required comprehensive analysis, relevant is that Chorus (and Telecom before it) never expanded UBA coverage over that rural footprint even when its UBA wholesale revenues were far higher via the retail minus pricing. So a price uplift now, to well short of those prices, is unlikely to expand the rural footprint. But, in the end, the fact that Government has provided subsidies via RBI (and now via a programme to extend the footprint of UFB) speaks for itself.

(f) That example shows how important it is to do the evidence based quantitative analysis, rather than just relying on brief and unsupported statements around investment incentives.

9.32 At [40] CEG note the ability of Chorus to push back fault restoration times, absent incentives via higher copper prices. If we assume that to be correct for present purposes, this must also be part of the detailed consideration of impacts on net consumer welfare, if it is relevant. The relationship between higher or lower monthly price on handling restorations is a decidedly long bow and a blunt instrument. Much more direct and efficient is the ability to control this, and to pay Chorus more, as appropriate, via the STD, and amendments to the STD if necessary.

CEG's Part 4 WACC percentile comments

9.33 CEG recycle a lot of argument considered and rejected in the context of the Part 4 WACC percentile review.[36] We don't cover this in our cross-submission as the Commission has considered and dismissed them already. We agree with Spark that:

> There has already been a thorough consultation process in relation to the specifics of estimating regulatory WACC for the purposes of the TSLRIC FPP process for UCLL and UBA, and many of the common generic issues have been the subject of extensive consultation, and consideration in the context of the Merits Review of the IM processes.[37]

9.34 By way of illustration, we also recap some of the High Court views on the Commission's WACC methodology. These references are in no way intended to be comprehensive:

> The argument that suppliers in fact borrow long (actually some of them – small ones – borrow from the bank) ignores their ability to use interest rate swaps. Given price resetting, firms that choose not to match their borrowing to the regulatory period are, so it seems to us (and subject to the arguments raised against the reliance the Commission placed on the availability and use of swaps) voluntarily taking on risk. If they need to be rewarded for taking on that risk, it should not be through higher prices paid by users.[38]

> We are not persuaded that it would be materially better for the term of the risk-free rate/debt premium to be fixed at 10 years or that the Commission made an error of law in setting a term of five years. We reach that conclusion essentially because of our assessment of the strength of the principle that the term of the risk-free rate should be aligned to the regulatory term to avoid over and under compensation. Nor were we persuaded by the range of supplementary arguments made by the supplier appellants.[39]

9.35 CEG also claim that, compared with providing an uplift for electricity and gas networks, "there exists a wider set of asymmetric consequences resulting from setting the prices of UCLL and UBA too high or too low which are independent of how the WACC is determined".[40]

9.36 The examples CEG provide, however, of "*inputs such as: … the costs of building the modelled network; the costs of operating and maintaining the*

[36] L1 Capital do the same in their submission.
[37] Spark, UBA and UCLL FPP pricing review draft decision, 20 February 2015, paragraph 340.
[38] Wellington International Airport and others v Commerce Commission [2013] NZHC 3289, paragraph [1263].
[39] *Wellington International Airport and others v Commerce Commission* [2013] NZHC 3289, paragraph [1287].
[40] CEG, Uplift asymmetries in the TSLRIC price, 20 February 2015, paragraphs 19 – 21.

modelled network; … demand for services provided by the modelled network; and … the asset lives and price trends of the network assets"[41] are applicable also to Part 4 pricing. For example, one of the concerns electricity distributors had with the Commission's draft DPP resets last year was that the Commission was overly bullish in its assumptions about demand growth, which would have resulted in understatement of the prices needed to recover a normal return.

9.37 CEG go on to argue that:

> Uncertainty in each of these factors around the best estimate also feeds through to variation in the modelled TSLRIC for the UCLL and UBA services.
>
> Since it is the prices for the UCLL and UBA services that determine the asymmetric consequences … it is uncertainty in these prices that gives rise to the need for an uplift. Providing for an uplift that allowed for only the uncertainty in the estimation of WACC would likely materially underestimate the uplift needed to allow for uncertainty in the price.

9.38 It is very clear from the Commission's Input Methodologies Reasons Paper,[42] and other Commission material, that the reasons for providing uplift are much wider than the possible asymmetric consequence of under-estimating WACC.

10. Chorus submission as to s 18 application

10.1 Chorus maintain[43] that all external experts agree that the risks of setting an inefficiently low price outweigh the risks of doing the opposite.

10.2 We do not understand that to[44] But in any event there are some key points of detail in this regard:

(a) The issue of setting the price too high or too low is to be decided, as CEG agree, in a real world context and not in a hypothetical world.

(b) It is likely that a **real world** evidence based empirical analysis will confirm Professor Vogelsang's impressionistic view that the hypothetical price does not need uplift to avoid the risk of under-estimation. Chorus still recovers considerable super-profits.

(c) The Commission has not carefully separated the hypothetical exercise from the real world exercise. It is submitted that there needs to be clear acknowledgement in the process that there are these two separate steps.

(d) In particular, TSLRIC, especially as to sunset networks and also where ORC for reusable assets is used, overcompensates the provider, beyond what is "efficient". It is not necessary to uplift the hypothetical price to avoid the risk of under-estimation. A careful **real world** evidence based empirical analysis will make this clear.

[41] CEG, Uplift asymmetries in the TSLRIC price, 20 February 2015, paragraphs 19 – 21.
[42] Commerce Commission, Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper, December 2010.
[43] At [5] of its February 2015 submission
[44] This was certainly not a view universally held in submissions on the Commission's Part 4 WACC percentile review last year.

10.3 The error in approach is illustrated by this observation by Professor Hausman:

> "If WACC or TSLRIC is underestimated, access seekers will find it in their economic interests to purchase the regulated access to legacy copper-based UCLL service instead of building an alternative fiber-based network. This distortion of the build or buy choice is inconsistent with the section 18 of the Telecommunications Act purpose statement of promoting investment in alternative infrastructure, and in turn promoting competition for the long-term benefit of end-users".[45]

10.4 This fails the CEG test of undertaking a real world analysis. If the real world analysis is done correctly, the answer is very different.

11. Experts should sign High Court code of conduct for expert witnesses

11.1 We have earlier submitted - without response to our submission - that experts should, before providing submissions, sign that Code,[46] amended to apply to the Commission, with its overriding obligation stated in the Code as:

> 1. An expert witness has an overriding duty to assist the [Commission] impartially on relevant matters within the expert's area of expertise.
>
> 2. An expert witness is not an advocate for the party who engages the witness.
>
> 3. …..
>
> 4. If an expert witness believes that his or her evidence or any part of it may be incomplete or inaccurate without some qualification, that qualification must be stated in his or her evidence.

11.2 The requirement for this to happen only for the conference leads to the following problems, which would largely be solved by requiring experts to sign before all submissions:

(a) As the above critique of Professor Hausman's and CEG's reports shows (similarly as to the Analysys Mason model), a more balanced expert's report instead of an advocate's submission would assist the Commission in focussing on the correct facts and issues and getting the right outcomes under the Act.

(b) Having to deal with such advocacy submissions requires considerably more time and cost for both the Commission and for stakeholders. The process can be completed more quickly.

(c) We consider that this simple step would make a considerable difference to the processes (cost and time) and outcomes.

11.3 Imagine if Analysys Mason had signed the code. We would not have a model from them at around two times the draft, at least in isolation. This internationally recognised expert on modelling would produce more balanced information, including, perhaps, the other models it confidentially did for Chorus. It would

[45] Jerry A. Hausman, Report by Professor Jerry A. Hausman, Response to the Commerce Commission's Draft Determination on Uplift, 18 February 2015, paragraph iv.
[46] In Sch 4 of the High Court Rules.

provide more valuable and balanced information, instead of forcing the Commission and stakeholders down side alleys. Both WIK and Network Strategies have confirmed that the Analysys Mason model is not TSLRIC. That begs the question as to why Chorus has got them to provide this model, implying its use is for purposes other than the Commission's deliberations (perhaps for media purposes?). The Commission has the power to control this via the Code.

11.4 Imagine if Professor Hausman signed the code and elevated his submerged footnote on already committed investment to its correct position: at the centre of his report.

11.5 Of course there is value in such disclosure by other experts too such as WIK and Network Strategies.

11.6 If an expert chooses not to sign up to the Code, then that affects the value placed on the evidence and submission. The Commission cannot compel acceptance of the Code by experts.

11.7 For our part, we are advocates. We advocate for end-users and the promotion of competition for the LTBEU.

12. FWA as part of the UCLL and UBA MEAs

UCLL

12.1 Chorus submit that, as FWA cannot be split into Layers 1 and 2, it cannot be part of the UCLL MEA. In any event, the Commission has limited the FWA footprint for the UCLL MEA to the RBI footprint.

12.2 As to that last point first, that self-evidently constrains the FWA part of the MEA to an actual footprint, when this is a hypothetical greenfields network. It is submitted that limitation is incorrect. The FWA footprint should be assessed on a greenfields basis. It is legally incorrect to limit the footprint to the legacy footprint for FWA.[47] The legacy footprint for the delivery points for the services (eg the FDS and end user delivery points for UBA) are correctly used, but not components in between. That moves the model to the Chorus legacy network away from the required hypothetical network. In a greenfields, the FWA footprint would not mirror RBI as RBI is designed to work around the legacy footprint needs.

12.3 MEAs and other TSLRIC components are just means to an end, and are not rigidly bound by certain functionality etc. The Act does not require that. The HEO, in rolling out a network with at least Layer 1 functionality, will roll out FWA, with its Layer 2 functionality, where FWA is cheaper. It would not make sense to do otherwise. Moreover, there is nothing that constrains the MEA to Layer 1 functionality: it just needs to be as good as or better. After all, FTTH (far superior to copper) is accepted as a MEA for copper and in the same way FWA can be too.

UBA

12.4 Thus far, as to the UBA MEA, the Commission has – incorrectly it is submitted – concluded that the UBA MEA can only be copper. Assuming this is corrected, then FWA can be the MEA too, even though it overlaps with the Layer 1 MEA. In fact it will have additional cost components, namely backhaul to the FDS. It is

[47] Repeating the same mistakes identified by the Courts in the TSO judgment.

constraining the TSLRIC modelling incorrectly to simply conclude that not having Layers 1 and 2 capability rules out the copper MEA. The ultimate purpose of this hypothetical exercise needs to be kept in mind and the Act in this regard does not require an unhelpful and unrealistic rigid approach.

13. Aggregation and related issues

Introduction

13.1 From the WIK February 2015 report on the detail of the modelling, it emerges that the so-called aggregation model is fundamentally flawed: see [4.2.4] and [4.2.5] of that report.

13.2 The high level description of the aggregated approach was and remains opaque, a key step being what in fact happens on the detailed modelling. Now that has become apparent.

13.3 It is difficult to understand the need and driver for the aggregated approach. It does not meet the requirements of the Act, for the reasons below.

13.4 It is not possible to comment fully on all other implications of the aggregated model save to note that it is expected that it does not produce the correct outcomes as to other aspects as well.

13.5 In this section, we will, having seen the WIK concerns, outline what the Act requires when modelling UBA and UCLL. We then turn to some other implications that are apparent, prior to the Commission providing greater detail in its statutory draft determination. We also deal with UCLFS.

The legal requirements - UCLL

13.6 In this section we refer to UCLL as follows:

(a) UCLL – the service that includes NUCLL and SLU

(b) NUCLL – non-cabinetised UCLL

(c) SLU – sub-loop unbundling.

13.7 For reasons given in earlier submissions, the Commission is required to determine the TSLRIC – as defined in the Act – for the 2 UCLL services, the non-price terms of which are in the NUCLL and SLU STDs.

13.8 The service delivery points for those NUCLL and SLU services are physically known points, being:

(a) For NUCLL the actual exchanges and the actual end user points; and

(b) For SLU the actual cabinets and the actual end user points.

13.9 The degree of optimisation as between those known service delivery points is a different issue from the service delivery points, which are fixed as what is being priced is the network components between those points. To model anything more than that would over-recover cost, and vice versa.

13.10 The TSLRIC of NUCLL can be calculated in a standalone way, and not on an aggregated basis, and likewise as to SLU. That is what the Act says and

expects. It is also how TSLRIC methodology works. An aggregated approach is both novel and unnecessary. For example, the cost of the network components between the cabinet and the end user can be separately calculated for SLU and likewise for NUCLL as between exchange and end user.

13.11 To the extent that NUCLL and UCLL share paths such as trenching, the cost is to be allocated in the normal way that TSLRIC modelling is done (which is not the so called aggregated method). Essentially there is a first step and only then does sharing, etc, become relevant in the calculations.

13.12 It is not necessary to calculate, for the purposes of calculating either NUCLL or UCLL, the SLUBH component. It appears that the aggregated model is some sort of reverse engineering designed to overcome a problem that is not apparent, given that SLU an NUCLL can be costed separately as standalones. Despite trying to understand and analyse the approach, we cannot understand the reasoning for that reverse engineering approach as explained in the draft determination and its predecessor documents. In any event, it is unnecessary, and, from WIK's observations, leads to error, at least as to including fibre backhaul in the UCLL price, when that cannot be a component of that price. That relatively simple error implies more problems with the aggregated model.

The legal requirements – UBA

13.13 The price is as follows:

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

13.14 The main components in those "additional costs" are:

(a) The lit fibre from the cabinet to the exchange (we'll call this "cabinet fibre backhaul"); and

(b) The network from the exchange to the FDS.

13.15 It is particularly important to be clear about the elements at play here, and it is submitted that part of the problem is that the Commission has not correctly dealt with the elements. For example, the Commission has treated the above "cabinet fibre backhaul" as sub loop unbundling backhaul (SLUBH) which is the regulated service, "Chorus's unbundled bitstream access backhaul". But although they share a path, SLUBH and cabinet fibre backhaul are not the same, for the former is a regulated service using cabinet fibre backhaul, just as UBA uses cabinet fibre backhaul (and therefore SLUBH is not an input into UBA, contrary to the approach in the December draft determination).

13.16 Treated correctly, that may make no practical difference but what emerges, it is submitted, is an error of approach overall on this aggregated model, including in this regard.

13.17 The service delivery points for the fibre cabinet backhaul (as an input into UBA) are physically known (namely the actual cabinets and the actual exchanges)

13.18 Cabinet fibre backhaul (the input into each of UBA, SLUBH and other services) shares network elements with other services such as copper in the same trenches. Cost sharing is to be addressed and allocated between services, but in the normal way this is done in TSLRIC modelling.

13.19 Essentially the modelling needs to get the order of the steps right, and done separately, instead of trying to merge them all into an aggregated process. Deriving the TSLRIC for each service (SLU, NUCLL and UBA uplift respectively), while done separately, can be efficiently coordinated.

13.20 There is no reason why the Commission cannot revert to a simpler and clearer model, using data points it already has namely the service delivery points noted above. This should be relatively straightforward, but if it is more challenging, it needs to be done.

Footprint of the NUCLL, SLU and UBA services

13.21 Unlike say a PSTN TSLRIC assessment, where core network elements and elements outside the DSL footprint on the end user side are at issue, this FPP is solely about the cost of the network elements between the above mentioned service delivery points. For NUCLL it is about the cost of service between actual exchanges and actual end user points. For SLU about the cost of service between actual cabinets and actual end user points. For the UBA service, about the cost of service between the actual FDS's and actual end user points. Add anything more and there is overpricing by including irrelevant components.

13.22 Any network element outside those service delivery points is irrelevant, except, as a second order question only, where those other network elements share paths, or where assessing them is relevant to say calculating fixed and common cost such as head office. But they only become relevant at that subsequent stage and not sooner.

13.23 From the WIK report, it seems that the modelling includes, at the first stage:

(a) Core network elements on the core side of (i) the exchange in the case of NUCLL (ii) the cabinet in the case of SLU and (iii) the FDS in the case of the UBA additional elements.

(b) Network elements beyond the DSL footprint (bearing in mind that being priced in the case of UCLL is not UCLFS which is a separate and different regulated service; it is, we have submitted, a service which is geographically limited in scope).

13.24 These points have been made in earlier submissions but they have not been responded to. We can submit on matters when they have been dealt with in the statutory draft determination.

UCLFS

13.25 At [110] of the December draft determination, the Commission refers to "two key views" without engaging in writing with other submissions including ours. For example, we submitted, among other points, that "full unbundled copper local loop network" refers to the full network including to rural areas outside the DSL footprint, given UCLFS is a voice input. The draft decisions can be responded to after the Commission addresses such submissions, which should also, it is submitted, be couched in an approach that is not "aggregated" (see [120] and [121] of the December draft determination).

14. GPON v Point to Point – legal framework

14.1 The Commission has chosen P2P as the MEA as, it is said, GPON cannot be unbundled. It is submitted that is contrary to the scheme of the Act, among other things.

14.2 Section 156AP, the moratorium on fibre unbundling regulation before 2020, specifically envisages GPON unbundling. It provides:

> 156AP Commission may not recommend or investigate unbundling of point-to-multipoint layer 1 services
>
> (1) The Commission must not, before the close of 31 December 2019, provide a final report to the Minister recommending the unbundling of any point-to-multipoint layer 1 service that is provided by an LFC that is subject to a binding undertaking.
>
> (2) The Commission must not, before the close of 31 December 2018, commence an investigation into the unbundling of any point-to-multipoint layer 1 service provided by an LFC that is subject to a binding undertaking.
>
> (3) An LFC is subject to a binding undertaking for the purposes of this section if it has entered into an undertaking that has been approved by the Minister under this subpart and that is still in force.

14.3 This of course refers to the UFB GPON initiative. The Act specifically envisages GPON unbundling. To exclude GPON as a candidate MEA would be contrary to the scheme of the Act.

14.4 Moreover, Chorus' own experts, Analysys Mason, have identified how GPON can be unbundled in their report to Ofcom, *GPON Market Review – Competitiive models in GPON: Initial Phase*.[48]

14.5 And CFH are unequivocal on this point. As they state:[49]

> **Q. Can the LFCs' GPON networks be "unbundled", so that RSPs can purchase "dark fibre" and add on their own services?**
>
> A: Yes, this is required to be offered after December 2019 in GPON areas. In P2P areas (mostly business areas and CBDs), Dark Fibre services are already available.

14.6 Legally that point is confirmed in Chorus' Network Infrastructure Project Agreement with CFH to build the network. Annexure 2 in that NIPA is specific about Layer 1 capabilty of this GPON network:

> 8. The provisioning of fibre in the Network allows for sufficient fibre to permit future Layer 1 unbundling post 31 December 2019, with:
>
> • two fibres per Premises from the Central Office to the Premises where a point to point architecture is chosen;

[48] http://stakeholders.ofcom.org.uk/binaries/research/technology-research/Analysys_Mason_GPON_Market_1.pdf
[49] http://www.crownfibre.govt.nz/ufb-initiative/frequently-asked-questions/

> • two fibres per Premises from the Splitter housing to the Premises where a Point-to-multipoint architecture is chosen;
>
> • sufficient feeder and distribution fibres, where a point to multipoint architecture is chosen, such that each Premises may be served by two distribution fibres fed from separate splitters, the second splitter to be provided and installed either by an Access Seeker or by the Company on behalf of an Access Seeker; and
>
> • sufficient fibre to allow for growth and in-fill housing.
>
> Company will be required to provide Layer 1 unbundling by December 31 2019. Company will have flexibility to determine best to manage the investment required to meet this obligation including how investment now is balanced with investment in the future.
>
> 9. The provisioning of both feeder and distribution fibre in the Network allows for forecast infill development, for the provision of point-to-point services to priority users as well as for redundancy and faults.
>
> 10. The Central Office(s) will provide accommodation and facilities for point to point Layer 1 Access Seekers.
>
> 11. The Company will provide accommodation and facilities for unbundled point-to-multipoint Layer 1 Access Seekers from 1 Jan 2020.

14.7 Therefore GPON can be a MEA candidate, and legally cannot be excluded.

14.8 As the FTTH rolled out in the market in fact is GPON, this implies a comparative analysis for choosing between GPON v P2P MEAs would show that the less costly GPON is the MEA. It would be a strange position for that to be otherwise (just as it would be strange if the FTTH MEA comprised only ducted connectivity without aerial).

14.9 It would also be a strange position for GPON not to be used in the MEA where the Chorus network is specifically designed for unbundling. Real life current network choices are the most telling evidence.

15. EUBA pricing must be based on cost – legal error

15.1 It is submitted that the gradient approach is not legally available as it is not a cost calculation.

15.2 Whatever the practice overseas, our Act requires the **cost** of each EUBA variant to be specifically calculated. If the model does not produce the necessary data, that is only because it does not do what the Act requires, and what TSLRIC requires. A so called gradient approach is no answer to the legal (and broader TSLRIC) requirements. The model needs to be fixed to produce the answer.

15.3 EUBA services are BUBA but with the stated bandwith prioritised ahead of other internet grade traffic. Just as complexities of regulated and commercial services are modelled, including the interplay between them over shared paths, the cost of say EUBA90 can be calculated. There is no justification for treating EUBA variants differently. The incremental cost of providing for prioritised traffic can be calculated. This is no different to what the Commission is doing elsewhere in its modelling.

15.4 Additionally, the price difference between variants, given the cost difference arises only out of prioritisation, is self-evidently grossly overstated, relative to cost.

15.5 There is a further issue: it is said by the Commission that "*a price differential is consistent with current international practice*".[50] In its forthcoming statutory draft determination, the Commission should refer to its sources for that practice and also deal with the UBA IPP determination's recognition that, in Sweden, the regulator removed the price differential, implying there should be none.[51] Chorus' expert, Analysys Mason recognised that the difference did not originally appear to be cost based, as stated in the IPP deterination:

> 283. Analysys Mason submitted that the price of the Swedish product we benchmarkedagainst was not determined in the Swedish cost model and it was unclear if the price was cost-based. Analysys Mason also noted that prices for the product had recently been updated and there was no longer a price differential.

15.6 But, whatever overseas practice is, in the end the price must be based solely on cost and not some other mechanism.

15.7 We turn now to the gradient approach proposed in the UCLL draft determination, namely retention of the gradient in the IPP determination. (As above, none of the gradient options are legally available but we deal anyway with this, and it demonstrates the legal error in any event.)

15.8 The IPP determination, for reasons that are not apparent, did not use the new Swedish approach (where the price is the same) and instead only used a Belgian benchmark. The Commission would need to deal with the former on the FPP.

15.9 First, on choice of this gradient, the Commissoin only says, at [361] that "*continuing with the existing gradient is the best approach given that TSLRIC costs for UBA do not provide a cost differential*". That thus far gives no reason beyond the lack of information in the TSLRIC model. Fulsome reasons will be needed in the statutory draft determination as to why the IPP based gradient is chosen so that parties can submit.

15.10 Next, using the Belgian benchmark simply does exactly what the FPP is designed to replace: it benchmarks the pricing. In this respect it makes no advance on the IPP. Further it ignores the Swedish benchmark (no price difference).

15.11 But no "gradient" or any other solution short of a costs solution is available in NZ and the difficulties with the IPP gradient approach demonstrate why in practice why that should be so.

16. Constant Demand Assumption

16.1 Our last submission pointed out that it was not reasonable to assume constant demand for broadband services, given the rapid growth in demand that is actually occurring in New Zealand.

[50] Para 341 Draft UCLL determination December 2014.
[51] At [283].

16.2 Since then, new data has has become available which puts New Zealand on the top of the OECD for fibre growth connections:

(a) New Zealand's growth in fixed broadband penetration from June 2013 to June 2014 was 5.4% (an increase in subscribers of 1.59 per 100 inhabitants);[52]

(b) Fibre penetration grew at the same time by 272% (compared to the OECD average of 12.4%);[53]

(c) Over the last 10 years, broadband penetration in New Zealand has increased from 3.45 per 100 inhabitants to 31.20, an increase of over 800%;[54] and

(d) Over the last 5 years, broadband penetration in New Zealand has increased from 22.64 per 100 inhabitants, an increase of 38%.

16.3 Submissions from Chorus and Network Strategies also highlight that a constant demand assumption is not plausible and will result in overstatement of TSLRIC prices.

16.4 Chorus, for example, submitted that "*Broadband services are a growth business. Bandwidth on Chorus' network has been growing exponentially due to increased connection volume and increased bandwidth usage per connection. New Zealand is starting to see the benefits of changing and emerging competition driven by demand from end-users for better broadband services, including entry by new participants and the development of new services based around HD streaming capability*".[55]

16.5 Network Strategies' provided evidence of recent growth of demand for broadband services, and also evidence of projections of population growth and densification, for example: "*In the latest population projections from Statistics New Zealand, it is expected that there will be an additional 312 900 people gained over the period from 2014 to 2020 … This will translate into more than 115 000 households, if we assume a constant household size*".[56]

16.6 The observation we have about population growth is that broadband growth can be expected to exceed population growth. An approach the Commission could adopt to reflect growth in demand for broadband would be to: (i) apply the latest population projections from Statistics New Zealand; but (ii) apply a multiplier to this to reflect the historic difference in population and broadband demand growth.[57]

17. Lead ins

17.1 We agree with and support the Spark submissions on lead ins.

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[52] http://www.oecd.org/sti/broadband/1.4-NetIncreaseYearly-2013-12-(LINKED).xls

[53] http://www.amyadams.co.nz/index.php?/archives/1414-NZ-tops-OECD-for-fibre-growth-connections.html and http://www.oecd.org/sti/broadband/1.11-FibreGrowth-2014-06.xls

[54] http://www.oecd.org/sti/broadband/1.5-BBPenetrationHistorical-Data-2014-06.xls

[55] Chorus, Submission for Chorus in response to DraftPricing Review Determinations for Chorus'Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 December2014) and Process and Issues Update Paper for the UCLL and UBA Pricing Review Determinations (19 December 2014), 20 February 2015, paragraph 59.

[56] 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, pages 10 and 11.

[57] Vector has recommended a similar approach to calculation of growth in demand for electricity services, as part of the Commerce Commission's DPP price resets under Part 4 of the Commerce Act.

18. Demand and use of available infrastructure

18.1 That all demand including over LFC services is included is supported.

18.2 However, in any event, (and also if such demand approach is rejected) our submission is still made that the modelling must include sharing of access to LFC and Chorus UFB infrastructure, just as access to electricity company infrastructure is part of the model. The easiest way to analyse the correct approach is our counterfactual analysis in earlier submissions. This remains a core part of our submissions.

19. Future proofing UBA - Chorus submissions

Our Section 30R Review submissions

19.1 As outlined in our February 2015 submission on the December draft determination, our s 30R submissions are a core part of the submissions on the UCLL and UBA FPP, on this and all other matters.

19.2 For example, a primary submission is that the UBA service should be future proofed including as to backhaul capacity over fibre to the FDS.

Fibre MEA for UBA

19.3 As submitted in February, the MEA will need to change so that it is fibre (with FWA). This impacts the way in which the HEO's network is dimensioned for future growth. For illustrative purposes we will deal with this issue in the context of the copper UBA MEA.

Chorus February 2015 submissions

19.4 Chorus, in Part 2 of its submissions, recognises the need for the UBA service to be dynamic and adapt to needs as they evolve. They are concerned that this is not priced in.

19.5 We agree that this should happen, or that there is some other solution that ensures that the regulated service does not become a ghetto. Part of this, as Chorus points out, can be the prospect of a review if dimensioning requirements differ from forecasts. This does not remove the need for careful review of cost components (which is beyond the scope of this submission).

19.6 As submitted in our s 30R submissions, these issues are best handled in the FPP instead of a s 30R review.

19.7 This is further reason why the pricing should be set on a year by year basis instead of a single averaged sum, so that later years capture the higher cost of greater capacity.

19.8 We are submitting elsewhere as to allocation of core network costs.

20. Backdating

Chorus is unfairly treating its customers

20.1 Chorus in its February submission claims that:

> … backdating … incentivises efficient entry and pricing decisions by RSPs prior to the FPP decision being known, as the industry can factor expectations in relation to the FPP price into their decision-making.[58]

20.2 This is a remarkably unfair statement for Chorus to make about its RSP customers, when Chorus well knows that it cannot reliably predict the likely range of Commission draft and final decisions, with its greater access to relevant network information.

20.3 For example, in December 2012, when the Commission released its final UCLL price and the draft UBA price, Chorus said in its stock exchange announcement in response(highlighting added):[59]

> Chorus has very serious concerns about the potential impact of these decisions. While noting that the UBA decision is a draft, and there is a process to run, management expects that the collective impact of these two changes (if the draft UBA decision were to become final) **could require Chorus to fundamentally rethink its business model, capital structure and approach to dividends.**

20.4 It is remarkable and unfair that Chorus would expect its customers to be able to predict price ranges and set aside funds and defer investments, when it also knows that the price range cannot readily be predicted and it clearly was not able to provision accordingly.

20.5 No RSP, large or small, can run their businesses like that. Chorus cannot run its business like that, and it's there in the stock exchange release for all to see. And Chorus is in the better position of largely not having competitors. That RSPs are well short of recouping current backdating after price increases, after the draft announcement in December 2014, demonstrates this.

20.6 Chorus even suggests in its submission, at [331], that all that RSPs need do is to look at share broker commentary to figure out where the price is heading.

20.7 If Chorus can't figure out the price range from its direct knowledge of its network, how are share broker commentators going to figure it out? (And all of us involved in this area have seen somewhat strange observations by those analysts, divorced from the reality and with varying understanding of the Telecommunications Act regulation.)

20.8 Additionally, a primary source of information for analysts is the analysed company: here Chorus. This opens up opportunities for gaming.

20.9 No economist, lawyer, or regulatory person engaged full time in these matters would reliably do more than hazard guesses.

Primary submission remains that backdating is not legally available

20.10 We have submitted, however, that backdating is not legally available at all. That remains our primary submission. (If that is not accepted by the Commission, our secondary submission is that a proper evidence based real world empirical

[58] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 December2014) and Process and Issues Update Paper for the UCLL and UBA Pricing Review Determinations (19 December 2014), 20 February 2015, paragraph 322.

[59] https://www.chorus.co.nz/file/8559/167839.pdf

analysis will show that backdating is negative for consumer welfare and should not occur.)

20.11 The current circumstances are distinguishable from the 2006 Court of Appeal decision, and the Commission is not bound by that judgment to conclude that backdating is available. It is able to start afresh and interpret the Act, as amended and in its current context. As we outline below, we submit that is very important that the Commission grapple with this opportunity: to do otherwise has future chilling consequences given the uncertainty as to investment that backdating creates.

20.12 In doing so, while the Commission can have regard to what the Court of Appeal has said, it is not bound by the judgment. It can take into account the changed regulatory environment, and also the valuable decision of the English Court of Appeal in *Vodafone v BT and Ofcom*. Given observations in that judgment, it is submitted that, if our Court of Appeal had before it the submissions and issues considered by the English Court of Appeal, there would have been a different result.

20.13 Reasons why the NZ Court of Appeal backdating decision is not binding include (these are already submitted and/or respond to points made by Chorus):

(a) This is an STD process, added to the Act after the circumstances to which the Court of Appeal judgment relates. It is submitted that this alone entitles the Commission to distinguish the judgment, in terms of binding precedent (as opposed to authority to which the Commission should have regard). Application of the precedent doctrine by the Commission would mirror application of precedent by the High Court. The points below merely add reasons as to why the judgment is not binding precedent.

(b) As outlined in our February submission, the time periods for the STDs differ from the regulated periods under review in the Court of Appeal. There is greater reason under the other process why there should be backdating. This is illustrated by a further point of distinction. In that case having no backdating would have rendered the price review determination ineffective. That is not the case on an STD.

(c) Since the circumstances under review in 2006, the Act has been through considerable changes, via the 2006 amendments around operational separation (which also added the STD process) and then the 2011 changes. Applying standard interpretation principles, specific sections in an Act are of course interpreted having regard to overall purpose and context, including the overall scheme of the Act. Part of that context is the parallel UFB arrangements, leading to Chorus structurally separating, facilitating and controlled by the Act. Changes as to price, relevant to the periods in question including the multiple provisions as to repricing, averaging and also freezing UBA prices for an extended period. In this regard, we note incidentally that we do not agree that freezing UBA pricing while having UCLL changes implemented immediately, after the review commenced by the Commission, implies that it was intended that there be backdating: to the contrary.

(d) Given these considerable changes to the Act, and to broader context, a decision on a provision in a very different Act cannot be binding precedent, no matter how similar that specific provision is.

(e) It is clear also that the Court of Appeal made the declaration with reference to specific facts that do not apply here. Therefore, it can only be binding as to those specific facts. For example, as we submitted at [4.10] to [4.13] of our February submission, the declaratory judgment was specifically referable to large corporations. As the Court of Appeal said, at [29]:

> Further, large corporations employ sophisticated financial mechanisms for reserving against adverse contingencies and a large corporation such as Telecom must itself have the ability and capacity to forecast with accuracy the likely price to be fixed by the Commission on a pricing review determination.

(f) The reference to Telecom back then of course included the Chorus network operation too. The decision cannot be binding, it is submitted, as to smaller operations (such as our client, Snap, and multiple other RSPs much smaller than Telecom including Chorus). We note in passing that events have shown that Chorus, did not have, contrary to the Court's decision *"….the ability and capacity to forecast with accuracy the likely price to be fixed".*

(g) There are a large number of matters, some of which are outlined in our February 2015 submission, which were not before the Court of Appeal. The position as to "efficient" is an example.

(h) A fulsome evidence based real world empirical analysis would show that backdating is negative for end users, is not efficient, and is negative for competition (the Court of Appeal having, with respect, incorrectly outlined the position as to efficiency as we explained in our February submissions).

20.14 *Vodafone v BT and Ofcom* shows compellingly why there should not be backdating, absent clear words to that effect. That is so as to those parts of the reasoning more broadly applicable beyond their Act, such as:

(a) In an ex ante regulatory context, there should not be ex post effect (and that this is a different form of retrospectivity, which was not dealt with by our Court of Appeal, than retrospectivity to a time before the Act came into force). (See [4.19] – [4.20] of our February submission). As the English Court of Appeal noted, as to backdating,[60] *"If such a surprising result had been intended, I would have expected clear statutory language to that effect.".* There was no such clear language there, nor is there here. On this point the Courts of Appeal in each country are starkly opposed.

(b) The observations that there are benefits in decisions, assuming no backdating, even if only a short time remaining, including because of precedential effect: moreover the regulator can control the process to thwart malingering parties. See [4.34] of our February 2015 submission where we cited the following passage from the *Vodafone v BT and Ofcom* case at [45]:

> I do not accept that the lack of a power to direct the retrospective revision of price controls renders the statutory appellate regime toothless, as contended by Mr Anderson. Even in this case, where the proceedings before the Tribunal and Commission took a very long time, it was possible to make a forward-looking

[60] At [42]

> modification of the condition for almost half the period of the price control under challenge. I recognise that proceedings of this kind are complex and that it may not be feasible in practice to achieve a speedy resolution of appeals or to obtain satisfactory interim relief pending their resolution; but the Tribunal can use its case management powers to deal with cases as expeditiously as practicable and to prevent abusive delaying tactics. In any event, the fact that the lapse of time limits the available remedies does not deprive an appeal of value. It can still serve an important purpose by identifying errors and ensuring that they are corrected for the future.

20.15 Finally, a more fulsome analysis of detriments and benefits for consumer welfare will point against an interpretation by which there is backdating. For reasons such as those at [4] of our February submission, such analysis was not considered by the Court of Appeal. Economic regulation is to be interpreted in context of economic theory and application, as many anti-trust and economics regulatory judgments confirm (the most well-known example being the judicial gloss, applying economics to monopoly provisions such as s 36 Commerce Act and the Sherman Act (US). There is a materially different regime from the position under the Act in 2006.

20.16 Further, there are the Lowndes Associates arguments that, due to the statutory cap, there can only be backdating downwards not upwards. Notably, the NZ Court of Appeal backdating decision was about reduction not increase. Contrary to the Chorus submission at [344] there is a "one way ratchet".

Chorus cannot backdate more than 100 days

20.17 Lowndes correctly identify that, in any event there cannot be backdating to more than 100 days before invoice, save that they incorrectly refer to that as a commercial legal matter, not a regulatory matter. This restriction is in the General Terms.

20.18 The General Terms in the STD are not a contract. They are part of the regulatory instrument that makes up the STD, an instrument having force pursuant to the statute. The Commission must review the price within the confines of the General Terms for it is reviewing the price assuming the non-price terms in the STD apply, including the General Terms.

20.19 That regulatory instrument is clear that Chorus cannot invoice and seek payment for services provided by it over 100 days before the invoice. That is a hard stop on liability. If there can be backdating, contrary to our primary position, the Commission can only backdate to 100 days before the final determination.

20.20 In any event, even if the Commission ordered backdating to before that 100 days, Chorus cannot recover as it is not permitted, by the regulatory instrument to invoice and seek payment. It has no way it can enforce that right.

Setting the right precedent is very important

20.21 The Commission has the opportunity to step in and end backdating once and for all. We strongly submit that the opportunity can and should be taken to do so. If that does not happen, there will be a chilling effect on investment when matters arise in the future, and uncertainty that generally does not benefit consumers. What do the successors to unbundlers do where there are IPP priced inputs?

What do the successors of UCLFS providers do where there are IPP priced inputs?

20.22 We can see that one solution, given s 18 opens up solutions by which there is only partial backdating, or no backdating in these particular solutions, is to arrive at a reduced backdating to reflect the consumer welfare balance. We can also see this as being a pragmatic sort of approach in these circumstances.

20.23 However, we think it better to take away the Sword of Damocles now. Otherwise, no matter what the solution, there will be a chilling effect in the future with, it is expected, only negative consumer welfare outcomes. As an example, see below the analysis as to the impacts on unbundling and consumer welfare.

20.24 In any event the decision, in order to reduce litigation risk can be made on two grounds:

(a) Correctly interpreted, there can be no backdating;

(b) In any event, if the Commission could backdate it will not do so here as that would lead to net negative consumer welfare outcomes.

20.25 It is submitted, with respect, that the reasoning in the Court of Appeal judgment, suffers from the inevitable difficulties faced by courts when dealing with complex economic issues and principles: it therefore does not undertake the fulsome economic analysis and efficiencies assessment that the Commission can and should do, as the experts in the area. The reasons for this are set out in our February submission.

20.26 The point is illustrated by the Court of Appeal in *R v Hines,* where Richardson P and Keith J noted that:[61]

> "…there are two major practical problems for the Courts in deciding public policy litigation: obtaining relevant information and then assessing it. Litigation under the adversary processes of the Courts is not an ideal vehicle for conducting a social or economic policy assessment. Traditionally the Courts have been largely dependent on the evidence and arguments which the parties elect to put before the Court and there may be serious gaps in the material.
>
> … The real problem, however, is that the Court processes do not allow public policy to be developed in the systemic way that is regarded as desirable elsewhere in government. Public policy development conventionally requires the identification and consideration of key policy elements; appropriate consultation and assessment throughout the processes; and cost benefit analyses during the various phases of the policy development programme.
>
> … By contrast, Courts cannot engage in community discussion and circulate draft judgments for public comment before committing themselves finally. As well, they are confined to the issues arising from the facts of the particular case."

20.27 It is submitted that the Commission has the ability not to follow the Court of Appeal decision, and that it should take the opportunity to do so, for it is the

61 *R v Hines* [1997] 3 NZLR 529, at 539-540.

expert decision maker, in a way that cannot be replicated by the courts. It can interpret and apply the Act accordingly.

20.28 This opens as an alternative an additional basis for deciding this matter so as to encourage certainly going forward, should the Commission decide that it must apply the Court of Appeal case: a decision that the efficiency analysis concludes that there would be no backdating, plus an analysis that shows, based on effficency analysis, the English Court of Appeal decision etc, that the Commission would have decided, if it was free to do so, that there cannot be backdating under the Act.

Other issues

20.29 We now deal with matters as though backdating is possible.

Timing

20.30 Chorus contends that "*backdating … ensures that all parties are incentivised to engage in the FPP process in a timely manner, as windfall gains cannot be obtained through delay where parties do not expect the pricing outcome to be in their favour*".[62]

20.31 As submitted in February, RSPs do not have such incentives, as the current situation shows, by which they are recovering less than they would have to pay if backdating to the draft FPP level is ordered.

20.32 Chorus' point was dealt with by the English Court of Appeal in *Vodafone v BT and Ofcom* and dismissed by it, on the basis that the regulator could control the procedure, in the passage quoted above.

Chorus recovering efficient costs?

20.33 Chorus asserts *"… if the FPP price is not backdated, this will inevitably mean that Chorus does not recover the efficient costs of providing the service for this period*".[63]

20.34 As outlined above it is critical that a **real world** s 18 analysis is undertaken, instead of the hypothetical assessment to which Chorus refers. It is likely that this will confirm Professor Vogelsang's view that Chorus is amply recovering super profits even at the IPP and backdating is not justified for that reason. This is but one factor in the consumer welfare analysis to be undertaken.

Efficiency and consumers

20.35 Chorus asserts end-users benefit from backdating eg "*the point is that it is consumers who benefit in the long run from backdating, through the efficient investment and price signals that the expectation and practice of backdating creates*".[64]

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[62] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus 'Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 December2014) and Process and Issues Update Paper for the UCLL and UBA Pricing Review Determinations (19 December 2014), 20 February 2015, paragraph 322.

[63] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 December2014) and Process and Issues Update Paper for the UCLL and UBA Pricing Review Determinations (19 December 2014), 20 February 2015, paragraph 329.

[64] Chorus, Submission for Chorus in response to Draft Pricing Review Determinations for Chorus' Unbundled Copper Local Loop and Unbundled Bitstream Access Services (2 December2014) and Process and Issues

20.36 This is just assertion. Again a proper real world analysis will show otherwise, and the position is also outlined in our February 2015 submission.

Backdating to December 2012

20.37 Chorus seek backdating to December 2012 at [328]. As outlined in our February 2015 submission and above:

(a) There can be no backdating;

(b) If there can, backdating is not required to the date of the IPP; instead the issue is determined by proper and real world consumer welfare analysis, which is expected to show there should be no backdating.

UBA price freeze does not justify backdating of UCLL

20.38 Chorus say at [335] – [345] that freezing UBA but not UCLL implies there should be backdating. We can see no reason why that would make such a difference. The regime works equally well if there is no backdating, and it cannot be interpreted as suggesting that there must be backdating. Instead, to the contrary this is consistent with no backdating.

20.39 Contrary to the Chorus submission, the negative effects on unbundlers and unbundling, and in turn on consumer welfare are considerable. Just as Chorus cannot predict price in the future (as it so graphically said in December 2012) nor can unbundlers do so.

20.40 Let us say that unbundlers faced a definite situation by which they must pay increased charges over the IPP, which they cannot predict in terms of amount. The implications include:

(a) Reducing investment as the risk is too high.

(b) Real difficulty in setting retail prices.

(c) Potentially being forced by market conditions to set prices below backdating figures, even where the price can be better predicted (eg the recent increases under-recover the draft backdating by a substantial margin: the position is far worse when there are few pointers).

(d) All that is poor for consumer welfare and likely greatly to outcome other factors in a proper assessment.

(e) The position becomes even clearer when we add UCLFS to the mix (where the backdating for Spark for 2 years will total in the order of $200M if the draft UCLL price becomes final.

Impact on RSPs is relevant to consumer welfare

20.41 Contrary to Chorus at [346] – [348], the impact of backdating on RSPs is highly material. First, for the reasons above, if there is backdating that will chill investment, against consumer welfare interests.

Update Paper for the UCLL and UBA Pricing Review Determinations (19 December 2014), 20 February 2015, paragraph 337.

20.42 Second, if an otherwise viable RSP is going to fail due to backdating, or its ability to compete is attenuated due to backdating, that also is a consumer welfare concern, as competition is reduced.

Chorus takes deferred payment

20.43 This does no more than ameliorate the problem, assuming the terms are viable. The fundamental problem remains.

Appendix A. Statutory duty to give reasons and engage with submissions

21. Introduction and summary

21.1 There are a number of grounds upon which the Commission must give sufficient reasons, including engaging in writing with submissions and evidence. In this appendix we focus on the statutory obligations to give reasons in the draft and final determinations.

21.2 In summary, we say, based on NZ, Australian and UK authorities flowing from *Poyser and Mills*[65] and from *Ansett v Wraith,*[66] that the statutory duty as to reasons requires the decision to sufficiently address a number of matters, including engaging with the substantive points raised by the parties. An aggrieved party must be able to say, quoting *Ansett v Wraith:*

> "Even though I may not agree with it, I now understand why the decision went against me. I am now in a position to decide whether that decision has involved an unwarranted finding of fact, or an error of law, which is worth challenging."

22. Our key focus – the statutory duty to give reasons

22.1 We will outline below what the cases say is required when giving reasons required by statute. At this point we will show the difference between (a) where a statute requires reasons and (b) where, for a court or other tribunal, there is no express requirement to give reasons.

22.2 To illustrate this, we refer to *Barton v Licensing Control Commission:*[67]

> "The Commission is not bound to deal with every submission made any more than a Court of law is bound to do so but the decision should leave any reasonable applicant with the view that the principal points made by the applicant have received proper consideration."

22.3 While that decision acknowledges that reasons should deal with the principal points made by the applicant, the law was then, and remains, that there is no general obligation on courts to give reasons (and so, by referring to obligations on the court, the obligations on the tribunal were minimal too). In 2003, the Court of Appeal in *Lewis v Wilson and Horton*[68] reserved for another time a review of the leading authority on courts giving reasons, namely *R v Awatere,*[69] which held:

> "…we are unable, with respect, to accept the view that there is any general rule of law which requires reasons to be given [by courts]…"

22.4 There are authorities to similar effect as to tribunals: that, generally, absent statutory obligation requiring it, administrative law does not require the tribunal to give reasons.[70]

[65] [1964] 2 QB 467.
[66] (1983) 48 ALR 500, 507.
[67] [1982] 1 NZLR 31.
[68] [2000] 3 NZLR 546, at [75] and [85].
[69] [1982] 1 NZLR 644.
[70] An example is *NZI v NZ Kiwifruit Authority* [1986] 1 NZLR 159, 167.

22.5 However, the telecommunications draft and final determination processes are in a particular and different category, as there is a statutory duty to give reasons.

22.6 The question then is: what must be included in the reasons?

23. What must be included in the statutory reasons?

23.1 The authorities in New Zealand, Australia and the United Kingdom are clear that the statutory reasons must adequately deal with the submissions by the parties.

23.2 Many if not most of the authorities on what must be included in statutory reasons rely upon the decision of Megaw J in *Re Poyser and Mills' Arbitration.*[71]

23.3 Megaw J stated:

> "The whole purpose of [the statutory obligation to give reasons in the Act] was to enable persons, whose property, or whose interests, were being affected by some administrative decision… to know, if the decision was against them, what the reasons for it were. Up to then, people's property and other interests might be gravely affected by a decision of some official. The decision might be perfectly right, but the person against whom it was made was left with the real grievance that he was not told why the decision had been made. The purpose of the [statutory obligation to give reasons] was to remedy that… Parliament provided that reasons shall be given and in my view that must be read as meaning that proper, adequate reasons must be given. The reasons that are set out must be reasons which will not only be intelligible, but which deal with the substantial points that have been raised… I do not say that any minor or trivial point that has been raised at the hearing, would be sufficient ground for invoking the jurisdiction of the court."

23.4 There are a number of additional reasons for these conclusions, some of which we noted in our earlier submissions.

23.5 Materially, O'Regan J added a further reason, in the then New Zealand Supreme Court, when adopting and applying the above dictum in *Clark v Rent Appeal Board,*[72] a case limited to appeals on questions of law. At issue was a statutory obligation to *"show the Board's reasons for the assessment".*[73] O'Regan J said:

> "The failure of the board to give reasons, in addition to the vices enumerated by Megaw J in *Re Poyser and Mills*… virtually denies the parties their right of appeal on a question of law. Without the reasons, they are unable to discern whether the board has applied a wrong principle."

23.6 That with respect overstates the position as errors of law can sometimes be discerned despite the absence of reasons. But O'Regan J's point will often apply.

23.7 The New Zealand cases that apply this dictum include that decision of O'Regan J, *Ronberg v Chief Executive of Department of Labour*,[74] *Patel (Bhai) v*

[71] [1964] 2 QB 467.
[72] [1975] 2 NZLR 24.
[73] [1975] 2 NZLR 24, 27.
[74] [1995] NZAR 509, 518-520.

Removal Review Authority,[75] *Chan v Minister of Immigration,*[76] and *Legal Services Agency v Haslam*.[77]

23.8 In the latter case, for example, Asher J said, relying on authority that in turn relied upon *Poyser and Mills*:

> "[68] A failure to provide reasons can be procedurally unfair and amount to an error of law: see *Lewis v Wilson & Horton Ltd* [2000] 3 NZLR 546 (CA). While there is no general and invariable duty to provide reasons, here there was a specific statutory requirement to do so: s 57(3) Legal Services Act 2000. In such a case the reasons must show that the decision-maker successfully came to grips with the main contentions advanced by the parties and must "tell the parties in broad terms why they lost or, as the case may be, won": de Smith, Woolf and Jowell *Judicial Review of Administrative Action* (5 ed 1995) 9-49, citing *UCATT v Brain* [1981] IRLR 224.
>
> [69] As stated in *Lewis v Wilson & Horton Ltd* [2000] 3 NZLR 546 paras [74] – [87] in a judicial context, reasons are desirable to ensure open justice, to ensure that the lawfulness of what is done can be assessed, and to ensure discipline on the part of the decision-maker as a protection against wrong or arbitrary decisions. In this case in particular the reasons must be adequate to enable a proper understanding by the parties and on appeal, of why the decision was reached: see *Ansett Transport Industries (Operations) Pty Ltd v Wraith* [1983] FCA 179; (1983) 48 ALR 500 (FCA); *Trompetter v Nursing Council of NZ* HC WN CP750/92 3 February 1994, Greig J; *Patel v Removal Review Authority* HC WN AP36/94 14 July 1994, Eichelbaum CJ."

23.9 In the United Kingdom, *Poyser and Mills* has been approved in the House of Lords[78] and, most recently, in the United Kingdom Supreme Court in *Uprichard v Ministers for Scotland* in which the Supreme Court summarised the position as follows:[79]

> "…. the reasons given [under a statutory obligation to give reasons] must comply with the test formulated by Megaw J in *In re Poyser and Mills' Arbitration* [1964] 2 QB 467, 478: that is to say, they must be proper, adequate and intelligible, and must deal with the substantive points that have been raised. ...[P]rovided the reasons comply with that test, the Secretary of State could not be challenged in that respect. He might decide that short reasons would suffice, or that a point was not substantive and thus needed little or no reasoning in his decision."

23.10 Often cited, including in New Zealand, such as in the passage quoted above from *Haslam*,[80] is the decision of Woodward J in *Ansett Transport Industries Pty Ltd v Wraith* where he said:[81]

> "The statutory duty to give reasons "requires the decision-maker to explain his decision in a way which will enable a person aggrieved to

[75] [1994] NZAR 419, 424-425.
[76] HC Auckland CP80/89, 8 May 1989, per Barker J at pages 15-16.
[77] (2007) 18 PRNZ 469.
[78] See for example *Westminster City Council v Great Portland Estates plc* [1985] AC 661.
[79] [2013] UKSC 21 at [47].
[80] For example in *Haslam v Legal Services Agency* (supra), *Chan v Minister of Immigration* (supra) and *Romberg v Chief Executive of Department of Labour* (supra at Page 520).
[81] (1983) 48 ALR 500, 507.

> say, in effect: "Even though I may not agree with it, I now understand why the decision went against me. I am now in a position to decide whether that decision has involved an unwarranted finding of fact, or an error of law, which is worth challenging"."

23.11 That dictum is a valuable way of looking at what should be done.

24. Do the multi-party and multi-stage Commission telecommunications process change this?

24.1 That this is a mutli-party and multi-stage process does not take away the obligation to deal sufficiently with submissions in writing.

24.2 There is no reason in principle why that would not be so. There are just the same reasons why the level of decision making is governed by the principles in *Poyser* and in *Ansett,* as applied in subsequent authorities.

24.3 The level of approach is, as the cases note, governed by context. There are multiple reasons here, why the level of granularity in dealing with the position is to be more detailed than in many other decisions. For example:

(a) For most of the telecommunications regulatory actions, there are considerable sums at stake. In this FPP to they are said by InternetNZ, TUANZ and Consumer to be around $140 million for every dollar up or down on the monthly prices, with a real prospect of net impact on even just one issue exceeding $1 billion. (Monthly prices are only one facet of what is being decided: as is submitted, one off charges in one respect have implications as big as the UBA uplift for example). Additionally there are the consumer welfare impacts noted by Spark in its submission. That calls for a much more detailed approach than is called for in other situations.

(b) Tentative decisions are made by the Commission throughout most of their processes. This iterative approach is highly valuable, but in the end the statutory draft determinations must deal with the up to date position on the parties' submissions. Often this can easily and economically be done, simply by referring to the earlier tentative decision and confirming the reasons still apply. However, the position is quite common that the earlier draft reasoning is repeated, without addressing submissions made subsequently.

(c) There is a firm impression that key submissions over multiple stages somehow get lost in the process, as they are not dealt with in writing at all, or minimally, or, as above, more recent submissions are not handled. That also points to the need for the ultimate draft and final determinations comprehensively dealing with submissions. There are quite a number of examples of this: certainly, submitters have a firm impression – justified or not – that key submissions have not been dealt with. That is one reason why the dicta in *Poyser* and in *Wraith* are so important in this context: to reassure stakeholders that their submissions have been handled.

24.4 But in the end, the point is made clear by the abovementioned UK Supreme Court of *Uprichard,* which involved a multi-party multi-stage process (around a large scale town planning issue in the Saint Andrews area). The Supreme Court saw no such distinction. We come back to that judgment below.

25. Extra cost of responding to decisions, and reduced clarity in the decisions.

25.1 Say it it is argued that there are the following reasons not to engage with not to engage in writing with all substantive submissions:

(a) To do so adds unnecessary expense and delay;

(b) To do so would add unnecessary bulk to the draft and final determinations, and would detract from, rather than improve, the intelligibility of the reasons and facilitation of appeal or judicial review rights.

25.2 If additional expense and delay be added, so be it. There is a great deal at stake here on the FPPs. But in any event, the round of submissions on 20 February for the FPP demonstrates how valuable that the additional time in doing adequate reasons including responding to submissions, is. Overall, expense and delay may well be markedly reduced by the Commission engaging with submissions.

25.3 Similarly, if the intelligibility of the reasons is reduced due to the bulk of the decisions, so be it: there is much at stake on most telecommunications actitivies. But in any event, there are plenty of options available to make the draft and final decisions intelligible. For example:

(a) As above, the Commission can incorporate reasons by cross reference to earlier papers (which in fact is what it does frequently) so long as subsequent evidence, submissions and other developments are handled sufficiently.

(b) The Commission can adopt a practice sometimes used by Ofcom:[82] put responses to submissions in appendices, so that the main points are clearer in the body of the decision.

25.4 Leaving aside the contrary observation of O'Regan J, that giving reasons facilitates appeals as to law, we cannot anyway see a basis on which more detail detracts from appeal or judicial review rights save for a very positive reason: we can see every reason why such rights would be reduced if the reasons are fully articulated, given the Court's deference to the Commission's decision making (see Matthew Smith's text on Judicial Review at [60.1.4]).

26. Dealing with each submission specifically.

26.1 We accept that, where appropriate, the Commission can take more of an omnibus approach to engaging with submissions. This point is well made by the Supreme Court in *Uprichard*:

> "48 It is in addition important to maintain a sense of proportion when considering the duty to give reasons, and not to impose on decision-makers a burden which is unreasonable having regard to the purpose intended to be served. In the present case, the Ministers received a plethora of objections to the plan and to their proposed modifications. To judge from the objections which the court has seen, many will have raised numerous distinct matters. The matters raised are likely to have been expressed by different objectors in different ways, with different

[82] But in more detail than Ofcom does.

> nuances. If the Ministers were to be expected to address, line by line, every nuance of every matter raised in every objection, the burden imposed in such circumstances would be unreasonable. In such a situation, where objections can properly be grouped in categories according to their general tenor, it is not unreasonable for the Ministers to respond to them on that basis, summarising in broad terms the gist of a group of objections and the reasons for rejecting them.
>
> 49 In the present case, it was reasonable for the Ministers to group the objections according to their subject-matter, and to organise them according to the relevant chapters of the finalised plan."

27. Engaging in writing with submissions in the draft statutory determination

27.1 The obligation to engage with submissions in the draft is to the same level as in the final, but of course with reference to all the submissions and evidence before the Commission prior to the issuing of the draft. Absent, that the parties will not have the reasons to respond to meaningfully after the draft determination. An illustration of this problem is the challenge faced when trying to submit on the Commission's draft decision that the Act only permits a copper UBA MEA, when no discernible reason was given, and the draft did not engage with the submissions made on the point. We and other submitters were forced to submit in the dark.

28. Level of engagement with submissions and reasons

28.1 Finally, we consider that the Commission needs to engage with submissions at a sufficient level of granularity, and that, where it has engaged with submissions, it has not always done so in sufficient detail during the various reviews it has undertaken. Further, there are some areas where factually the absence of dealing with submissions may be deduced. Additionally, to the point at Para 6 above, there are points where we consider that the Commission has overly grouped submissions and thereby not dealt with substantive submissions.

28.2 Rather than engaging with each point and treatment of submissions thus far, it is submitted that there is sufficient material in the above to provide guidance. However, we think it is useful to reiterate some observations by the High Court in the IM judgment, for they are valuable in framing the appropriate approach:

> "No supporting analysis was provided … 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.[83]
>
> "… we have some sympathy … that the … approach to the asymmetric costs of over and underestimating the WACC lacks a solid basis."[84]
>
> "[1744] We have two final comments. First, this is not the only instance where economic experts have proposed an adjustment, in

[83] *Wellington International Airport and others v Commerce Commission* [2013] NZHC 3289, paragraph [1462].
[84] *Wellington International Airport Ltd & Ors v Commerce Commission* [2013] NZHC 3289 [11 December 2013], paragraph [1470].

this case 1.0% – 2.0%, where it is clear that there is no basis for that specific magnitude. We do not accept that this type of expertise provides a basis for making such an estimate or proposal. No-one, economic expert or otherwise, can credibly state that the WACC should be increased by some specific magnitude to account for a given factor except by reference to hard evidence. We consider the 1.0% – 2.0% proposal to be without foundation.

[1745] Secondly, this challenge has provided another example of an economic proposition being stated without justification being provided: in this case, that only ex ante compensation for Type II asymmetric risk could have the desired effect of promoting efficient investment. We do not consider that statement to be self-evident or so generally accepted as to require no argument in support of it. Where a proposition is simply asserted by economic experts, we give it little or no weight."

Appendix B. Letter to Commission dated 13 March 2015

13 March 2015

Stephen Gale
Telecommunications Commissioner
Wellington

Dear Stephen

FPPs

This letter enquires if the Commission will now revisit its timetable, particularly as to the statutory draft determination currently timetabled for around 2 months away.

The submissions raise a large number of matters which, it is submitted, cannot be dealt with in time for a legally compliant statutory draft determination in May. The inference is that continuing with the current timeline will lead to legal error by the Commission as to how it is handling the required process steps and how it is handling the substantive issues. As to substantive matters, those often come back to process errors by the Commission, it is submitted (for example, the absence of engaging with submissions, as is legally required).

This letter does not address the multiple other concerns raised in the submissions that point to more time and input being appropriate: the focus of this letter is on the more direct legal requirements (although the Supreme Court TSO decision shows how far the courts will go on a review of facts where an appeal as to law only is possible).

As has been submitted, the December draft determination purported, incorrectly, to be the statutory draft determination and that, if it was the statutory draft, it would not have been legally compliant. Substantial change would be required. For example, the Commission did not engage in writing with key submissions, as the law requires it to do. It is submitted that, if the Commission engaged with those reasons, the draft decisions would be different eg as to choice of UBA MEA.

It is submitted that remedial steps should be taken now, thereby avoiding the need for litigation and delay in the process: it is therefore better to be clear and upfront about the concerns, partly because there has been little or no written engagement with those concerns by the Commission.

These issues arise in a number of places so we give only one example here: the absence of evidence based empirical analysis in relation to s 18 (which is also an obligation that applies to all other facets of the FPP process).

Instead of an evidence based empirical analysis, the Commission has largely relied on the sort of high level observations for which the High Court (a Judge and two highly experienced economists) firmly criticised the Commission in its IM decision

The Commission has proceeded in this way, despite the following points, of which only one is enough to legally require evidence based empirical analysis, but taken together,

it is submitted that the requirement to do so is particularly strong from a legal perspective:

1. The Court of Appeal authority requiring the Commission to undertake quantitative cost benefit analysis;

2. The Commission's own clearly stated requirement in telecommunications matters of this nature that an evidence based quantitative CBA is required (and the fact of its implementation of such evidence based quantitative CBAs on a number of occasions[85]);

3. The IM judgment's firm criticism of the Commission's approach of not undertaking adequate evidence based empirical analysis;[86]

4. Contrary to the position on the FPPs, the Commission remedied the position on Part 4 WACC, in light of the IM judgment, by undertaking evidence based empirical analysis. It is submitted that it is difficult to understand why the Commission is doing the opposite here and that it continues to rely upon an approach that was disapproved by the court. (A simple example out of many: the High Court did not accept that the Commission could simply rely upon the unsupported statement that dynamic efficiencies trump static efficiencies: yet that is exactly what the draft determination does).

5. All the above points have been submitted on, including back to the IPP, and they raise relatively straightforward differences between (a) what the Commission is required to do (and what it does) and (b) what it is doing here.

6. At no stage however has the Commission engaged in writing with those submissions (contrary to its legal obligations to do so).

7. It is difficult to see how the Commission could explain to a court how it is handling this process, when:

    a. the process it is adopting is legally incorrect, in the face of such clear legal material as outlined above including clear direction from the courts;

    b. it is, without giving any reason or any answer to submissions on the point, departing so much from its clearly stated past practice in telecommunicaitons and from its practice under Part 4 (where it did the opposite of what is happening here, following the IM judgment).

The legally required evidence based empirical analysis - prepared to a sufficient standard - could not be completed before the May date for the statutory draft determination. There is not enough time. Similarly as to multiple other issues that have been raised. If that draft statutory determination is not deferred, implicit will be an error of law.

There are quite a number of other steps that cannot be completed by May either, in a way that is legally compliant, such as the necessary re-working of the UBA modelling to fix the UBA MEA choice (when the process requirement to engage with

[85] Professor Voselgang's reference to challenges in quantifying benefits and detriments is limted to remote implications: this is expressly dealt with by the Commission's treatment still requiring quantitative analysis where available, as stated in the LLU decision.

[86] It is submitted that the Part 4 decision, and the Court of Appeal decision noted above, are not materially distinguishable and they create legal obligations in telecommunications, in the overall context.

submissions on the point was not followed) and the treatment of re-usable assets contrary to Supreme Court authority and the Commission's own practice on TSO.

As noted above, much to be preferred is to see compliance rather than the need to litigate later as to process and substantive alleged errors. The shape of such litigation would need to await the statutory draft determination even if continuing on the current path makes it implicit there will be then error of law (whether by (a) declaratory judgment and/or judicial review before the final determination (that is the course CallPlus took in the related matter of the Minister's handling of the "copper tax" issues) or (b) by appeal and/or judicial review after the final determination). Should the matters not be resolved, while we do not have firm instructions (that is not possible until the statutory draft determination is available as the detail determines what is appropriate), it is anticipated, from discussions, that there would be litigation as to the Commission's alleged process and substance errors, given what is at stake.

As appears from submissions, there is particular concern with what is happening generally on this FPP including as to the choice of speed ahead of other factors, which end up being reflected in the matters to which there is reference above and in submissions. This letter deals with only one facet.

There is, additionally, one specific issue, arising out of submissions: will the Commission confirm that it will hold a statutory conference after the formal draft determination is issued. If not, we have been asked to advise further as to the legal position of such a radical departure from long standing Commission practice, even though the Act does not expressly require such a conference. To be clear, a conference before the statutory draft is welcomed even though it is not a statutory conference. That is because an iterative approach is valuable. But a conference after the statutory draft determination is sought to address the latter: anything before then is to a large degree in the dark, as many of the submissions made so far show.

Finally, it is submitted that these issues (and the multiple issues raised by others) should not be solved by tinkering with minor changes to the approach such as extending timelines of the existing structure here and there. A fulsome rethink would be best (via a process workshop as Spark suggest is a good option).

Yours sincerely

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Principal

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Appendix C. Lack of empirical analysis fatal for Chorus

28.1 Submissions by and on behalf of Chorus contrast with the substantive evidence, including various quantified analyses, that regulated suppliers submitted to the Commission in response to the 2014 Part 4 WACC percentile review.

28.2 The onus is on Chorus to produce sufficient evidence and analysis to support its claims (eg as to uplift).

28.3 In the Part 4 proceedings, the Commission had said:

> …submitters [namely, regulated suppliers] have not provided any factual evidence to suggest that existing regulatory valuations will fail to provide them with the opportunity to earn at least a normal return on the original cost of installing the assets used to supply regulated services. Reference to existing regulatory valuations when establishing initial RAB values under Part 4 should therefore give regulated suppliers no concern about the recovery of future investments.[87]

28.4 In the IM judgment, the High Court also recognised the onus on regulated suppliers to produce evidence and analysis to support their submissions (highlighting added):[88]

> The Commission's approach to setting initial RAB values, and to the related issue of revaluation gains, had – as the Commission argues – been on the table since at least the time of the December 2009 Emerging Views Papers. In that context we think the general absence of any suggestion that initial RAB values determined under the asset valuation IMs are in fact set at a level too low to allow recovery of at least normal returns on past investments counts strongly against the appellants' arguments that those initial RAB values are, in Part 4 terms, fundamentally flawed.
>
> In reaching that conclusion, and as already indicated, we agree with the Commission's Experts where they observed: …**The regulated firms have had the resources, incentives and opportunity to present any evidence of financial loss. As we understand it, no such evidence has been presented…** In this context, we do not regard the calculations presented by Drs Carlton and Bamberger for Vector as constituting such evidence. These experts start with similar recitals of history as Synergies and CEG, but take things further by predicting (large) dollar values of *consumer* welfare losses arising from insufficient future investment by Vector. **We consider these estimates unsubstantiated – no convincing argumentation or evidence links the causes and effects that are claimed**; there is, for example, no estimating of the sources and size of the 'rate shock' that it is implied will trigger the later problems – but the fact that they have been presented further underlines our contention that, if they exist, it should be possible to develop and present evidence of any significant financial losses that will be incurred by Vector under the Commission's proposals.

[87] Commerce Commission, EDBs-GPBs Reasons Paper at [4.3.7], 3/7/001082; Airports Reasons Paper at [4.3.10], 2/6/000676.
[88] *Wellington International Airport and others v Commerce Commission* [2013] NZHC 3289, paragraphs [774] and [775].