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Submission on backdating in relation to draft UCLL and UBA pricing review determinations

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1. Summary

1.1 This submission supplements our other submission in this matter and also the submissions by InternetNZ, TUANZ, Consumer, Snap and CallPlus.

Commission not required to follow Court of Appeal judgment

1.2 The Court of Appeal clearly stated that there is to be backdating back to the initial IPP determination. However, that statement does not bind the Commission, nor should it be applied by the Commission without full analysis under s18. That is because:

(a) That was not an issue which the Court of Appeal was asked to decide. It was only materially asked to decide whether the new pricing came into effect on the FPP determination date, and no more. The actual date of the new prices commencing (other than the FPP determination date) was not a matter before the court.

(b) This is at the heart of the importance of the obiter doctrine, a doctrine that still applies strongly even though, in some areas, some lawyers regard it as somewhat technical. It would be wrong, and lead to poor outcomes, for subsequent events and subsequent parties (who are different) to be bound by an appellate statement based on issues that simply were not being decided by the appellate court. That would involve taking a statement in a case about a different matter out of context, where that issue has not been fully considered by the Court.

(c) There is a subsequent and valuable England and Wales Court of Appeal decision on the comparable UK telecommunications legislation which highlights, for example, that backdating should not happen absent clear legislation, in this context of ex ante regulation.

(d) A key point is that the NZ Court of Appeal predominantly focussed on the view that the TSLRIC price is the most efficient, and therefore there should be backdating. However, references to “efficiency” in that context are to the price established by TSLRIC and the IPP/FPP: it is based on the cost of a hypothetical efficient network. That use of the word “efficiency” is much narrower than “efficiencies” in the sense of static and dynamic efficiencies (or, more particularly, such efficiencies as specified in s 18). It is, we submit, critical to distinguish the two types of efficiency. An “efficient” price does not necessarily mean that backdating is efficient overall in a s 18 efficiencies sense.

(e) An adequate quantitative s 18 analysis, based on evidence, is expected to produce the conclusion that there should be no backdating (including because of the uncertainty implicit in backdating).

(f) We add that it is well recognised by regulators and commentators that TSLRIC (particularly for sunset networks) does not produce the most efficient price. Professor Vogelsang confirms so. The IPP and the FPP TSLRIC should not be assumed to produce an efficient price. To the contrary.

(g) Therefore the Commission can, indeed must, it is submitted, approach the actual backdating date afresh, governed by broader s 18 considerations. At most, the only conclusion that can be taken from the Court of Appeal

judgment is that the new price can commence on a date before the FPP decision.

(h) Even that conclusion is questionable in this new context. The circumstances are different now, such that what is only a declaratory judgment is not binding on the Commission in these circumstances. Just as the facts are different so too is the statutory framework (for example as to structural separation and as to STDs).

1.3 Those currently applicable factual circumstances are overviewed in the submissions of the consumer NGOs, Snap and CallPlus (in addition to references below).

Backdating is not available under the Act in any event

1.4 It is also submitted that, despite the Court of Appeal's decision that backdating is possible, there is in fact no power to backdate, in this context. Therefore it is not necessary to do an efficiencies analysis. In particular the Act has been materially amended, since including by the 2006 and the 2011 amendments. For example, this is an STD, with no time limit, whereas the Court of Appeal was considering a time bound s 27 determination.

1.5 We have set this submission out after the above, in light of the relevance of the points we make about the Court of Appeal decision. For example, the 2010 *Vodafone v BT and Ofcom* judgment, to which we refer above, demonstrates that in a context such as this, backdating should not be an option unless the Act clearly states that it is. It does not do so here.

1.6 The Lowndes Associates submission is also still relied upon and that shows, for example, that there is a regulated constraint on backdating prices further than 100 days before the FPP decision.

Backdating, s 18, quantitative analysis and evidence

1.7 As we explain in our other submission of today's date, it is submitted that the Commission is required to undertake a sufficiently comprehensive quantitative analysis when making its decisions on backdating based on the evidence. As to backdating, s 18 has a dominant role, unlike some of the other FPP decisions to be made by the Commission, as we outline in our other submission today. Therefore, the analysis is to be focussed on the s18 purposes which all pivot around promotion of *"competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers."*

1.8 Section 18 is solely about end-users. Even s 18(2A) is, expressly, solely about the interests of end users.

Matters relevant to the Commission's decision

1.9 While we submit a comprehensive quantitative analysis based on the evidence is required, we add information on relevant considerations for when the Commission decides the issues.

Order of this submission:

1.10 We first summarise the apparent implications of the Court of Appeal judgment;

1.11 Then outlined are generally applicable principles, especially s 18;

1.12 Following that, we address the Court of Appeal's reasoning. We use this as a means of demonstrating the effect of a comprehensive s 18 efficiencies analysis in this context.

1.13 We then address the submission that backdating is not permitted in any event, notwithstanding that judgment. We note the Lowndes and Associates submissions in that regard, on which there is reliance still.

1.14 We summarise the overall position, with reference to the information in the consumer NGO, CallPlus and Snap submissions.

1.15 Finally, we provide details on a number of matters relevant to the decisions to be made by the Commission.

2. Implications of the Court of Appeal decision

Court of Appeal statement

2.1 In *Telecom v Commerce Commission and TelstraClear,*[1] the Court of Appeal stated:[2]

> "In our view Harrison J was right to uphold the contention by the Commission and TelstraClear that a price review determination relates back to the date of the initial determination. That is consistent with the substitutionary nature of reviewing or appellate decisions which vary an original decision."

2.2 If this clearly stated dictum, and the reasons given to support that conclusion, are applied here, the Commission must backdate to the initial dates on which the IPP charges apply.

Court of Appeal is not binding and must not be applied automatically by the Commission

2.3 However, we submit that, not only does the statement not apply here, save (perhaps) as to the conclusion that the price can be backdated to a date before the final FPP determination, it would be incorrect legally to simply apply that statement to backdate to the date the IPP price first applied.

2.4 That is because the judgment is, materially, solely dealing with a declaration sought by Telecom, declaring that the FPP price cannot take effect prior to the date of the FPP determination.

2.5 Although it is apparent that the Court of Appeal considered the issue of backdating to the IPP inception dates, that was not a matter for decision. For example, we cannot be sure that the parties made full submissions on broader matters and that the Court gave adequate consideration. The observations below indicate otherwise. We identify a number of issues apparently not before the Court, or at least not dealt with by the Court.

[1] CA75/06; 25 May 2006.

[2] At [44].

2.6 But in the end, that is irrelevant. The dictum is obiter and not binding. The Commission must decide the issue afresh in our submission, as outlined above in our summary.

2.7 For those reasons, too, the Commission would err if it simply applied the statement. Of course it can and should have regard to the reasons outlined in the judgment for backdating to the IPP date, but those reasons are not binding.

Circumstances are different

2.8 We note also that the declaratory judgment issues are focussed upon facts and issues of some years back. The facts have changed and, in particular, the legislative framework has changed. Most relevant are the 2006 and 2011 amendments including as to structural separation.

3. Approach to backdating: applicable principles

3.1 The Act is silent on how backdating is to be applied. (We will submit below that this silence means that there can be no backdating but for the present we will assume that backdating is available). We agree with the draft Commission position and with other submissions that the decision as to whether and how to backdate is dominated by s18.

3.2 For the reasons outlined in our other submission dated today, we submit:

(a) This requires a clear focus solely on the interests of end-users of telecommunications services. That pivotal role of promotion of competition for the LTBEU includes as to dynamic efficiencies (s18(2)) and as to s18(2A)'s *"incentives to innovate that exist for, and the risks faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services."*

(b) A quantitative analysis is required based on the evidence.

3.3 We will generally not return below to those requirements, but they are in our submission universally applicable on all backdating issues. They demonstrate our view that the s 18 efficiencies analysis as to backdating extends beyond the Court of Appeal's focus upon efficient pricing.

4. Reasoning in the Court of Appeal's backdating judgment

4.1 In this section, we will address the Court of Appeal's reasoning, in order to demonstrate that the appropriate conclusion is that backdating is a matter to be decided having regard to all section 18 factors and efficiencies, and the solution is not limited to imposing the FPP price from the IPP price commencement date. We will address in turn the main conclusions of the Court of Appeal.

Clarity as to two different types of "efficiency"

4.2 At [15] the Court of Appeal stated:

> Whether made under s 27 [IPP] or s 51 [FPP], a price determination has the character of a proxy for the most efficient agreed price for a purpose specified in s 18. A s 51 determination does not supplant a s 27 determination because the latter is wrong, but because the former must be regarded as more efficient by reason of its more sophisticated methodology.

4.3 It is important to distinguish two different but overlapping uses the word "efficient".

(a) First, the efficiency dealt with in the quote, namely "the most efficient…price". This reflects the hypothetical efficient network, that is, cost, translated into price.

(b) Second, economic efficiencies in the sense of dynamic and static efficiencies, in this instance as encapsulated and expanded in s 18.

4.4 The first is a sub-set of the second, not the same.

4.5 If the price derived from TSLRIC is truly "efficient" in the first sense:

(a) that feeds into the broader efficiency analysis and may also be the largest factor in that broader efficiency analysis, as that underpins why the HNO concept is used;

(b) But it is not the only consideration in a broader efficiency analysis. For example, the inefficiencies as to uncertainty in pricing due to backdating is also a consideration in the efficiencies analysis too (in our view, a highly material consideration which may well lead to there being no backdating).

4.6 We assumed above that the price derived from TSLRIC is the truly efficient price in the first sense. It is, however well recognised by regulators and commentators that TSLRIC is unlikely to produce the most efficient price, particularly for a legacy network in its sunset years. One need look no further in the extensive literature, not to mention widespread departure by regulators away from the problems with TSLRIC to other models such as RAB, than the Commission's own expert, Professor Voselgang, where he said:

> "the TSLRIC method currently proposed by the NZCC is likely to be substantially more than needed by Chorus for covering the cost of is copper access network. Thus, the copper access network is likely to remain highly profitable"[3] and "even if the Commission were to reverse its stand on the re-use of civil works would Chorus be [sic] able to generate substantial profits from its UCLL and UBA offerings".[4]

4.7 Therefore, a TSRIC FPP price, and its IPP proxy (it is a proxy for the FPP price as the Court of Appeal confirmed last year[5]) are unlikely to be, in the words of the Court of Appeal in the backdating case, "a proxy for the most efficient agreed price". That is, it is submitted, a step too far. On a s 18 efficiencies analysis, which the Commission is required to undertake, to rely solely on the fact that the price is "efficient" would be incomplete (and in any event, the TSLRIC price is not truly efficient for the reasons above).

4.8 While the FPP is likely to be more "efficient" than the IPP in the first sense above, it is better to be clear that no more is happening than the IPP is a proxy for the more accurate TSLRIC FPP price.

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

[4] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, paragraph 118.

[5] In Chorus v Commerce Commission

4.9 We note also that the Court of Appeal acknowledged anyway, at [43], that there is a broader efficiencies analysis to be undertaken (even though the judgment was dominated by the efficiency of the price in the second sense above).

> "…arguments about efficiency do not point in only one direction. On the one hand, there may be efficiencies of certainty for a long period, but on the other hand there will be inefficiencies implicit in the lengthy operation of a less efficient price.".

The participants have changed: new and smaller players

4.10 The Court of Appeal states 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."

4.11 That records an observation of Harrison J, with the Court of Appeal having adopted most of his reasoning.

4.12 As explained in the submissions of the consumer NGOs and CallPlus, it is not realistic for smaller RSPs to provide for contingencies such as this (in fact it is also not realistic for larger RSPs to do so either, it is submitted). Additionally it is not possible to predict to any reliable degree of granularity where the FPP price will end up relative to the IPP. Prior Commission decisions, which understandably move material through drafts, illustrate that prediction is very challenging. A range of a substantial number of dollars is possible here, given choices applied by the Commission that cannot be predicted and the complexity and volume of relevant data.

4.13 It is also not possible to reliably set retail prices to reflect estimated prices and backdating, and this has a negative effect on consumers too. That uncertainty has a major impact.

4.14 Like all issues on the s 18 assessment there needs to be fulsome analysis based on the evidence.

Retrospectivity

4.15 The Court of Appeal rejected submissions based on relating back and the presumption against retrospectivity, at [33]:

> "One example of the submissions is that a relating back of the reviewed price would offend the presumption against retrospectivity. We agree with Harrison J's conclusion that the Act does not purport to have retrospective effect. It provides for prospective s 27 determinations and prospective s 51 determinations. It is obvious, of course, that the Act does not purport to allow a s 51 determination after the Act came into effect, to bear in any way on conduct or events which may have occurred before the Act came into effect. Section 27 determinations did not exist before the Act came into effect."

4.16 This is correct to the extent that the Court is referring to retrospectivity in the sense that there is a presumption an Act does not apply to events before the Act commenced. Clearly the backdating here does not offend that presumption.

4.17 However the Court of Appeal did not address a different sort of retrospectivity: retrospectivity (backdating) for periods **after** the Act commenced.

4.18 This issue was however addressed in a subsequent England and Wales Court of Appeal judgment on backdating regulated telecommunications charges, namely, *Vodafone and others v BT and Ofcom* [2010] EWCA Civ 391.

4.19 At issue was whether regulated mobile termination rates decided by Ofcom should be backdated following a successful appeal by which they were increased. Many of the issues in the case pivoted around the specific wording of the UK Act comparable with our Telecommunications Act. Those are not largely not relevant here. But there are valuable observations, applicable here, on a number of issues, including as to retrospectivity. There, the Court of Appeal concluded that the absence of a statutory backdating provision in their Act told against backdating. Richards LJ, in delivering his judgment, which the other judges agreed with, said, as to backdating to a date after the Act commenced (highlighting added):

> **41. Mr Anderson [for BT seeking backdating] submitted that the revisions directed by the Tribunal and given effect by Ofcom in this case were retrospective only in the sense that they "touched on the past".** In my view, however, they were truly retrospective (or retroactive) in character, purporting to alter the content of past obligations; they did not merely refer to past events in order to determine the content of future obligations. They amended for each of the four years 2007-2011 the terms of a condition that, by section 45(1)(a), was *binding* on the MNOs to whom it was applied. I do not see how breach of a binding condition could be anything other than a contravention of that condition for the purposes of the Act. If, therefore, the amendment was valid, its consequence was that MNOs who had complied with the condition in the first two years of the four year period became retrospectively and unavoidably in contravention of the condition in respect of those two years; which, in turn, brought them within the scope of the enforcement provisions of sections 94 to 104, albeit Ofcom might be expected to exercise in their favour the various discretions it enjoys under those provisions.
>
> **42. If such a surprising result had been intended, I would have expected clear statutory language to that effect. There is no hint of it in the straightforward language of section 45(10)(e). That is a further reason for reading the power of modification in the way I have indicated. I do not think it necessary for this purpose to have specific resort to the presumption against retroactive legislation as a canon of construction or, therefore, to resolve the competing arguments as to whether the presumption is capable of applying in this particular context**.

4.20 That judgment also refers to the CAT's conclusion that it is relevant that telecommunications regulation is ex ante not ex post. It is submitted that the ex ante nature of telecommunications regulation is also an important point against backdating. To backdate would be to erode the predictability and future looking nature of ex ante regulation. Clear words are required in the Act to move away from an ex ante approach.

Commerce is unpredictable

4.21 At [34] and [35] of the NZ Court of Appeal judgment:

> Telecom submitted that "The usual commercial expectation where services are provided and utilised is that the terms of supply are established in advance. Those terms may be expected to inform the user's decisions on the quantity of services acquired and on the pricing of its own downstream services to customers. In Telecom's submission that expectation is properly applied to a s 27 [IPP] determination, and it would be contrary to that expectation retrospectively to adjust the price for access services already provided. Accordingly, in Telecom's submission, the sequential or linear nature of the separate s 27 and s 51 determinations of itself support the conclusion that the "new" price applies only prospectively – to services provided after the later determination is made public and enforceable."
>
> The Court of Appeal responded to that submission in the next paragraph at [35]: "We think this argument, in reality, amounts to saying that the Act must envisage prospective application of a reviewed price because it is inefficient to make decisions in respect of supply and to act on those decisions on the basis of an assumption which may ultimately be altered. Of course that is so, but decisions made on contingent assumptions are a common feature of commerce. In relation to the present matter, if a revised price were not to relate back that would in itself result in inefficiencies. That is because the revised price must be more efficient than the initial price. Just as an initial price is more efficient than a disagreement and should therefore dictate the price for supply, so a revised price is more efficient than an initial price and for that reason should dictate the price of supply. A sequence which is said to be significant to interpretation is simply a reflection of the reality that any process of review necessarily involves a sequence."

4.22 The Court of Appeal also drew an analogy between what happens when a civil appeal succeeds from a lower court judgment. The new orders are substituted retrospectively for the old. By analogy that should happen here too (see [44] of the judgment).

4.23 It does not follow however that a s 18 efficiencies analysis should conclude, by analogy with what happens generally in the commercial market place (uncertainties etc), and what happens on appeal in courts, that such uncertainty and backdating should apply to the FPP. For the reasons above, clear language would be needed in the Act, to the effect that there is backdating to the date of the IPP inception.

4.24 From an efficiencies analysis perspective it is expected that a sufficiently complete analysis based on the evidence would show there should be no backdating. But the key point here is that this analysis needs to be done and it is not enough to proceed by way of analogy with other circumstances (in fact, those other circumstances should be irrelevant, as the issue here is different).

Just wealth transfer?

4.25 The Court of Appeal notes at [41]:

> "Telecom submitted that the s 18 purpose was not promoted by backdating. The consequence of the sequential nature of s 27 [IPP] and s 51 [FPP] determinations would be that any backdating over the "initial" period will merely transfer wealth between the provider and the user of a service. We find the argument unpersuasive. If the reviewed price is lower than the initial price the end users will have paid an inefficiently

> excessive price for the service. But if it is higher the end users would have paid an inefficiently inadequate price for the service. Absent the possibility of the consequences being passed on to the end users in some way, the potential for inefficiencies in relation to end users is unavoidable on either the Telecom position or the respondent's position. What can be achieved, however, is the establishment of the most efficient price as between the access provider and the access seeker."

4.26 There is, it is submitted, a fundamental error in the Court's reasoning on this, for it seems[6] to be assumed that there will be full pass through of backdating to the end user: *"If the reviewed price is lower than the initial price the end users will have paid an inefficiently excessive price for the service. But if it is higher the end users would have paid an inefficiently inadequate price for the service."*

4.27 As the consumer NGOs and by CallPlus explain in their submission, full pass through is most unlikely. In fact, CallPlus and Snap show that it is not happening, by a large margin (and in Snap's case there is no pass through). The position is therefore significantly more complex. This comes back to the key point that a s18 efficiencies analysis requires close analysis of the actual evidence.

4.28 Additionally, there is the issue outlined at the start of this analysis of the Court of Appeal judgment. By focussing on "the establishment of the most efficient price as between the access provider and the access seeker", the Court is limiting its review to that first version of efficiency (an efficient price) and does not extend to the broader s 18 efficiencies analysis, of which the efficient price is only one aspect (and it is not an efficient price anyway in the first sense of efficiency outlined above).

Court of Appeal's summary conclusions

4.29 At [44] the Court concludes:

> "In our view Harrison J was right to uphold the contention by the Commission and TelstraClear that a price review determination relates back to the date of the initial determination. That is consistent with the substitutionary nature of reviewing or appellate decisions which vary an original decision. The alternative view implies a potential for negativing the efficacy of the review process which the Act has established in order to serve the s 18 purpose. Moreover, the obvious function of the price determination regime is to fix the price for a period of time relevant to the application, not to fix the price for part of that time and another price for another part. We consider that the s 18 purpose is better served by substituting the revised price for the initial price *ab initio* rather than only after a period of relatively less efficient pricing. None of the arguments advanced on behalf of Telecom has persuaded us to the contrary."

4.30 As explained above, a full s18 efficiencies analysis is required based on evidence, and it is not enough to proceed by analogy with what happens on appeals in court: the absence of clear words pointing to backdating in the statute points against backdating, in this ex ante context.

[6] The analysis is a little difficult to follow.

4.31 The efficacy of the review process is not negative if there is no backdating. To the contrary, we expect a proper efficiencies analysis will show that backdating would be inefficient overall.

4.32 Moreover it is submitted that this observation should not be applied to the FPP based on STDs:

> "Moreover, the obvious function of the price determination regime is to fix the price for a period of time relevant to the application, not to fix the price for part of that time and another price for another part."

4.33 The Commission can set an extended period for the application of the FPP, and indeed it is proposing that this be an additional 5 years. It is not at all "obvious" that the period for the changed price should include the period prior to the FPP date.

4.34 This point is articulated well in the subsequent decision referred to above, *Vodafone v BT and Ofcom*, 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 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."

5. No backdating is available in any event

5.1 While it is submitted that a s 18 analysis is expected to show that there should be no backdating, it is also submitted that, despite the Court of Appeal's backdating decision, there is in fact no power to backdate. Therefore it is not necessary to do an efficiencies analysis. In particular the Act has been materially amended since including by the 2006 and the 2011 amendments.

5.2 The s 27 determination regime had a mandatory expiry date - often 2 years. The STD regime, applicable here, has no expiry date. However, the price review period of an STD does expire and the Commission is consulting on how long that period should be. The initial period will probably be 5 years.

5.3 Central to the Court of Appeal's conclusions was that not having backdating would render the FPP decision as academic, as the s 27 determination would have expired.

5.4 As the STD has no expiry date, the same issue does not arise.

5.5 It is submitted that the Commission is not bound by the decision that there can be backdating before the FPP date, and can conclude that backdating is not available.

5.6 Central to that position is that, for the reasons outlined above, there should be no power to backdate, absent clear words in the Act. There are no such clear words.

5.7 There are also a number of submissions by Lowndes Associates which have not been dealt with in writing by the Commission and those submissions remain.

5.8 For example, it is there submitted that the STD (which is a statutory instrument like delegated legislation and not a contractual instrument as suggested by Lowndes) precludes backdating, back further than 100 days before the FPP decision, as all invoices must be issued within 100 days of the services being rendered. That is consistent with the Lowndes argument that there should only be the ability to backdate by decreasing and not to backdate by increasing price.

6. There are clear and substantive reasons why backdating of any price increases should be rejected

6.1 There are clear and substantive reasons why backdating of any price increases should be rejected, in addition to our concerns above as to reliance on evidence and sufficient quantitative analysis. It is submitted that there are the following concerns about the Commission's preliminary view on backdating:

- It creates uncertainty and result in unpredictable pricing outcomes. The Commission has emphasised predictability in its draft decisions, but we cannot think of a single element of predictability which is more important than Chorus and Access Seekers knowing the current prices for access services.

- Backdating would exacerbate relativity/price squeeze concerns. For Access Seekers that use UCLL services only, the draft decisions result in higher UCLL prices and a smaller margin between UCLL and UBA prices. This is also a facet of unpredictability: the RSPs made investment decisions based on assumptions at the time as to input costs, only to find they are later changed against them.

- Backdating is unnecessary to enable Chorus to recover costs. No evidence has been provided by Chorus, the Government,[7] or the Commission that the IPP prices are not adequate to ensure Chorus recovers its actual costs (including a normal return on investment). The only evidence that has been provided was by Vector, which suggested the IPP prices would enable returns in excess of 20% per annum.

- Backdating would result in higher prices to end-users, based on the draft decision prices exceeding the IPP prices. We have already seen moves by Access Seekers to increase broadband prices in response to the uncertainty the Commission has created.

- The Commission is going to undertake at least 7 more months work on the FPP decision, including issuing revised modelling and draft determinations. There is no reason to expect this or the FPP price determinations will resemble the 2 December 2014 draft decisions, so the 2 December draft decisions do not lessen the difficulty in setting retail prices. Further, the 2 December draft decisions are an incomplete set of prices as they don't include one-off charges.

[7] As was made clear in numerous submissions in relation to MBIE's Telecommunications Act review consultation.

- Backdating a more "efficient" FPP price does not result in more efficient pricing because the prices are unknown so Access Seekers and end-users cannot efficiently respond to them.

- Backdating would undermine the function of the IPP.

- Backdating is inconsistent with outcomes of workably competitive markets/and would effectively allow Chorus to mis-use its substantial market power.

6.2 We discuss each of these points below.

Preliminary view that price increases should be backdated creates uncertainty and means current access prices are unpredictable

6.3 The Commission has placed particular emphasis on "predictability" in its draft UCLL and UBA price decisions. The Commission has stated "We consider that we should give weight to choices that provide greater regulatory predictability …"[8]

6.4 The Commission also stated it had "elected to conduct a more streamlined process than advocated for by some parties … driven by the desirability of providing the industry and the market with certainty and stability as soon as practicable".[9]

6.5 It is surprising, therefore, that the Commission's preliminary view on backdating makes no reference to predictability or certainty.

6.6 It is submitted that predictability and certainty principles, to the extent they are relevant, would also apply to consideration of whether to backdate. The Commission has not provided any valid grounds for making a distinction between predictability of approach versus predictability of outcome, or why the former is more important for ensuring incentives to invest.

6.7 Not backdating would provide the industry and end-users greater "certainty and stability".

6.8 We struggle to think of any decision that could do more harm to predictability, or create more uncertainty, than a decision to backdate; which means Chorus and Access Seekers do not know the price of UCLL and UBA services for the period from 1 December 2014 until the Commission makes its final price determinations.[10]

Draft backdating decision is based on assertion and judgment, and is not supported by analysis or evidence

6.9 This is dealt with in more detail above. The Commission has set out the following criteria for whether it should backdate:

- We agree with the submission that section 18 will provide us with the most important guidance.

[8] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, 2 December 2014, paragraph 126.1

[9] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, 2 December 2014, paragraph 6.

[10] For more commentary on predictability refer to the sections of this submission: "The Commission places too much weight on "predictability"" and "The Commission is harming predictability, not improving it".

- In particular, any decision to backdate will need to be demonstrably efficient.
- Likewise, a backdated sum payable to the access provider (either as a lump sum, or "smoothed"), or a backdated price reduction in favour of access seekers would need to demonstrably promote competition in a way that is likely to directly benefit end-users.
- We are open to smoothing any backdated sum.[11]

6.10 We are broadly comfortable with this criteria but it is the detail that counts: the evidence and the analysis, as we outline above. The Commission has essentially based its backdating decision on the assertion "We consider that if companies are financially disadvantaged by the timescales of the FPP process, this may harm investment which, in turn, would not promote competition for the long-term benefit of end-users".[12]

6.11 The high level approach behind this statement is such that, while the Commission considers it needs to consider backdating on a case-by-case basis, the arguments it has relied on could simply be applied to any regulated supplier that is expected to be granted a price increase.

6.12 With respect, there is no analysis or evidence to support this position. The Commission is repeating the same errors it made in its initial Part 4 WACC IM decision.[13]

Backdating is unnecessary to enable Chorus to recover its costs

6.13 While the Commission asserts Chorus would be financially disadvantaged if the FPP determinations were not backdated, consideration needs to be given to what is meant by "financial disadvantage". Does the Commission mean Chorus would not be able to recover its costs (including a normal return on capital) or its excessive profits would be lessened? It would appear the latter is the case in this instance.

6.14 No evidence has been provided by the Commission or Chorus that backdating is required to ensure Chorus can recover its actual costs (to the extent this is a relevant consideration). Quite the opposite. The Commission has noted it recognises "Chorus may have accumulated gains from providing UCLL over time".[14] Ingo Vogelsang has noted "the TSLRIC method currently proposed by the NZCC is likely to be substantially more than needed by Chorus for covering the cost of is copper access network. Thus, the copper access network is likely to remain highly profitable"[15] and "even if the Commission were to reverse its stand on the re-use of civil works would Chorus be [sic] able to generate substantial profits from its UCLL and UBA offerings".[16] It is clear from Professor

[11] Commerce Commission, Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services, 9 July 2014, paragraph 299.
[12] Commerce Commission, Process and issues update paper for UCLL and UBA pricing review determinations, 19 December 2014, paragraph 22.
[13] Refer to the section of this submission: "The draft decisions are overly reliant on judgment to justify price uplifts".
[14] Commerce Commission, Draft pricing review determination for Chorus' unbundled copper local loop service, draft determination, 2 December 2014, paragraph 643.
[15] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, paragraph 24.
[16] Ingo Vogelsang, Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand, 25 November 2014, paragraph 118.

Vogelsang's comments that both the IPP and FPP prices are more than sufficient to ensure Chorus recovers a normal rate of return, and will actually recover excessive returns.

6.15 The only evidence on the financial implications of the IPP prices for Chorus has been provided was by Vector, which suggested the IPP prices would enable returns in excess of 20% per annum.

6.16 We accordingly question the nature of the financial disadvantage arising from the timescales of the FPP process Chorus may incur and how this "may harm investment which, in turn, would not promote competition".[17]

6.17 We are also concerned the Commission has not adequately considered the financial impact on Access Seekers of not knowing the prices they will pay of UCLL and UBA services, and how this would impact on investment and competition. If the price changes apply only from after the FPP determination is set, Access Seekers will be able to adjust their prices/business strategies to help mitigate any financial disadvantage they may face, and to help ensure their ongoing financial viability. The Commission needs to consider the potential financial disadvantage to Access Seekers.

Backdating price increases will result in higher prices to end-users

6.18 We have already observed upward movement in prices for broadband services. One of the problems backdating creates for Access Seekers is they cannot backdate any increase in prices to their customers. In order for Access Seekers to recover potential backdating costs, therefore, they need to increase their prices (relative to what is needed based on the IPP access prices) from 1 December 2014. That is, if the market conditions permit that.

6.19 Uncertainty about the size of the backdating cost (the FPP could be substantially higher or lower than the prices in the 2 December drafts) may result in Access Seekers adding a risk premium onto prices. (This is particularly the case given Chorus' TSLRIC modelling disclosures result in substantially higher prices than the Commission's 2 December drafts – which suggests there is a risk that the amount of revenue that would be recovered through backdating could be higher than indicated by the draft decisions.)

6.20 The result could be higher prices for consumers, and the potential for prices higher than justified by the FPP final price determinations (if they were known).

6.21 We agree with the concerns expressed by Vector:

> If a retrospective price increase was introduced retailers could not retrospectively adjust their retail prices to offset the price increase which could impact on their ability to recover their costs. The retailers would need to either absorb the cost themselves or try and pass it through into higher future prices. The difficulty retailers would face with trying to recover past costs from future prices is two-fold:
>
> a. First, the retrospective access price change would not impact on retailers' forward-looking costs or marginal cost of supply and therefore would not impact on their profit maximising retail prices. The retrospective price increase would effectively be a sunk cost

[17] Commerce Commission, Process and issues update paper for UCLL and UBA pricing review determinations, 19 December 2014, paragraph 22.

to the retailer. If a retailer could profitably increase its prices to recover past costs, this would suggest that its prices were not set profit maximising levels. This would mean the retailer could increase its profits by increasing prices regardless of whether or not the retrospective access price change occurred or not.

b. Second, the cost to a retailer of a retrospective access price change is not a cost a new entrant retailer would incur, or would be incurred by a smaller retailer (that used the access service less). If the retailer attempted to recover these costs through higher (future) prices, it would face the competitive constraint that other retailers would be able to profitably undercut them.[18]

A related factor that the Commission should consider is the impact of the uncertainty about the FPP determination prices relative to the IPP determination prices, and how the differences will be treated, would have on retailers. In particular, retailers face the risk that the access price will be adjusted upwards retrospectively.

Retailers may have to factor in the uncertainty about the final access price, and the possibility that it could be adjusted upwards retrospectively into their retail price setting. The competitiveness of different retailers may then not simply be a function of the quality and cost of their respective services. It could also reflect different judgments about the likely difference between the IPP and FPP prices and what the Commission will do in terms of backdating and retrospective price adjustments. Different retailers may add different risk premiums to their retail prices, depending on their perception of risk, even if they expect the FPP prices to be lower than the IPP prices.

A perverse, but entirely plausible, outcome could be that this uncertainty results in higher than otherwise retail prices. Access prices are then retrospectively adjusted downwards following the FPP price determination, and this downward adjustment is not passed on to consumers but is instead a windfall gain to retailers.[19]

There is no "draft determination" to lessen the difficulty in setting retail prices

6.22 The Commission has stated "we recognise that it is difficult for retail service providers to set retail prices when their input prices are subject to backdated changes and that the backdating of changes that have not been anticipated by the market may simply result in a wealth transfer. These problems may, however, be lessened where a draft determination has been published."[20]

6.23 The Commission has also suggested its "draft determinations" reduce the uncertainty over price created by the backdating draft decision, but we would remind the Commission:

- The 2 December drafts are not draft determinations, as defined by the Act;

[18] Vector, Submission to the Commerce Commission on the Scoping and Issues Discussion Paper for UCLL TSLRIC, 14 February 2014, paragraph 52.
[19] Vector, Submission to the Commerce Commission on the Scoping and Issues Discussion Paper for UCLL TSLRIC, 14 February 2014, paragraphs 56 – 58.
[20] Commerce Commission, Process and issues update paper for UCLL and UBA pricing review determinations, 19 December 2014, paragraph 22.

- The 2 December drafts are an incomplete set of prices as they do not include one-off charges;

- There are the difficulties with the draft December position outlined at the start of this section of our submission;

- The Commission plans to issue draft determinations on 29 May 2015. We would expect the revised TSLRIC cost calculations to be substantially different (lower) than the 2 December drafts, given the number of flaws and errors in the way the Commission has applied TSLRIC in its modelling, and the 2 December drafts will be a poor indicator of the 29 May draft determinations and the final determinations;

- The Chorus TSLRIC modelling is substantially higher than the 2 December drafts. The Commission will presumably have to review this modelling. While we would expect the Commission to reject the modelling, as it did with Chorus' (nee Telecom) TSO modelling, on the basis it is not TSLRIC,[21] and grossly inflates prices,[22] there is a risk to Access Seekers (and end-users) Chorus' modelling could influence the Commission to set higher TSLRIC prices. (That, presumably, is the purpose of Chorus' issuing grossly inflated TSLRIC price modelling.)

- All those factors show how uncertain predicting the ultimate prices is.

6.24 There will be, based on the Commission's timeline, 6 months when Access Seekers operate absent a draft determination price (including one off charges) and another 3 months until a final determination is made. This uncertainty can simply be alleviated by a decision not to backdate.

Backdating a more "efficient" FPP price does not result in more efficient outcomes

6.25 In principle, if the TSLRIC prices are determined appropriately this should result in more efficient prices than the somewhat arbitrary prices that result from the IPP benchmarking. This does not mean backdating would result in more efficient outcomes, however.

6.26 Access Seekers (and end-users) can only respond to prices that are known at the time. Access Seeker (and end-user) decisions from 1 December 2014 until the final FPP determinations would be based on the IPP prices (absent backdating), but won't be based on the FPP prices (with backdating) because these are unknown.

6.27 Application of an unknown FPP price will not result in more efficient outcomes, because if you don't know the price of goods and services at the time you are purchasing them you cannot make efficient consumption decisions. It doesn't matter how "efficient" the FPP price is when it is finally determined.

[21] We understand Chorus essentially selected the version of the Analysys Mason modelling that resulted in the highest UCLL and UBA prices. The modelling undertaken by Analysys Mason essentially calculates Maximum Replacement Cost, rather than TSLRIC.

[22] Refer to this submission's "Appendix: Chorus' modelling confirms the Commission should not rely on its TSLRIC price calculations, and should be wary of the advocacy work undertaken by Analysys Mason".

6.28 We would suggest more efficient outcomes will arise from Access Seekers (and end-users) responding to a known price (the IPP) rather than an unknown price (the FPP).

Backdating is inconsistent with outcomes of workably competitive markets

6.29 No supplier of wholesale goods or services in a workably competitive market would be able to offer their goods or services at an unknown price. For example, if Sony attempted to supply electronic goods to retailers such as Harvey Norman at a price that would be established at a later date, the retailers would cease selling Sony products, and only sell brands such as Panasonic and Samsung. The only reason that backdating is possible for UCLL and UBA services is because they are natural monopoly services and Chorus has substantial market power. The purpose of the Act (section 3) is to regulate the supply of telecommunications services not to enable use of substantial market power.

Backdating would undermine the function of the IPP

6.30 The IPP provisions in the Telecommunications Act have two fundamental functions:

- They enable the determination of the access price more quickly than undertaking TSLRIC modelling; and
- They provide a low cost way of determining the access price (as long as the Access Provider and Access Seekers can live with the IPP price, and don't apply for an FPP). This mirrors Part 4 of the Commerce Act and its dual default price-quality path (DPP) and customised price-quality path (CPP).[23]

6.31 A problem that backdating creates is that it undermines the first function of an IPP. If the process is: (i) determine IPP; then (ii) determine FPP; and (iii) backdate the FPP to over-ride the IPP it will take longer for the access price to be determined. (Including longer than if there was no IPP mechanism and you went straight to FPP.) If the UCLL and UBA IPP prices stand (with no backdating) then current access prices are known. If backdating is used to over-ride the UCLL and IPP prices the current access prices will not be known until at least September 2015.

7. Conclusions

7.1 It is submitted that there can be no backdating.

7.2 However, if there can be backdating, a s 18 efficiencies analysis determines whether and how this happens, based on quantitative analysis of the evidence.

7.3 Some pointers as to the evidence and analysis are above and are in the consumer NGO submissions.

[23] Section 53K of the Commerce Act states that "The purpose of default/customised price-quality regulation is to provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances."