



UCLL and UBA FPP: further consultation and supplementary paper

Cross submission | Commerce Commission

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Contents

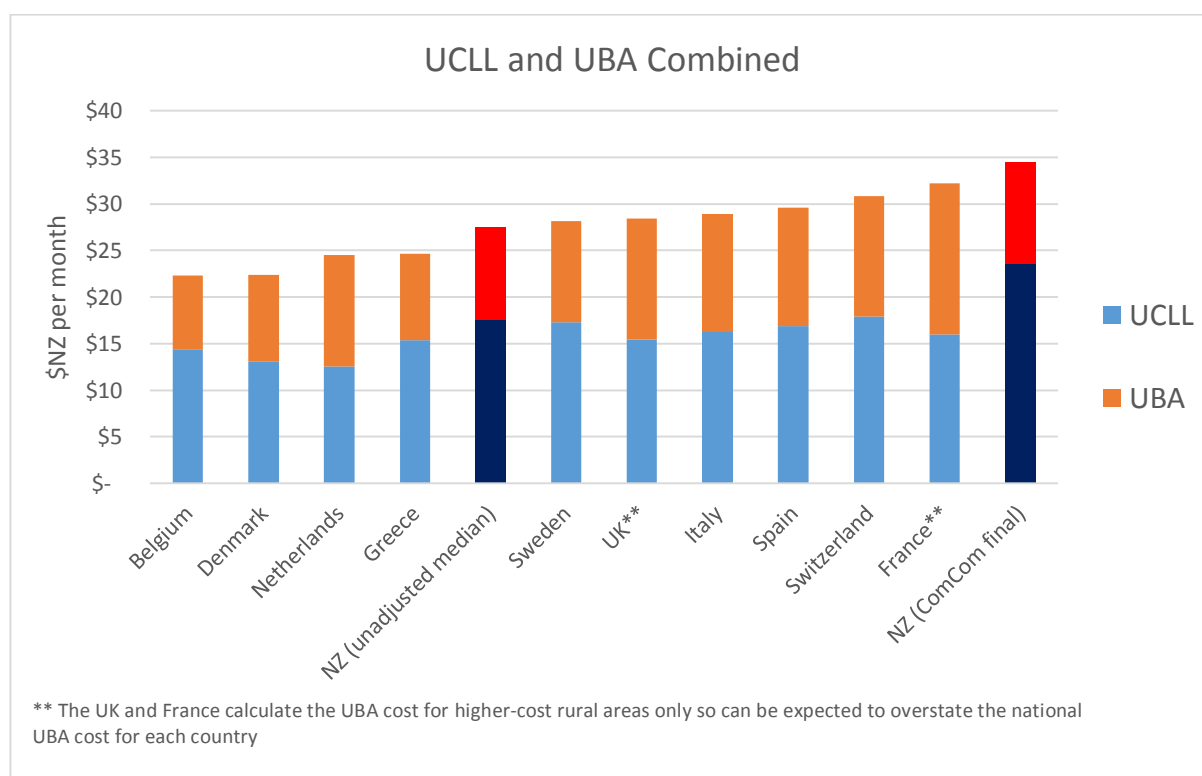
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Executive Summary

The next stage of the Commission’s process is critically important and requires further consultation. It will give parties clearer information on whether there is any reason to believe that New Zealand is fundamentally different to other countries that have set cost-based prices for UCLL and UBA in a way that might result in costs that fall outside the known European cost-based range

In September 2013 we submitted benchmarking of the total aggregate prices for UCLL and UBA services in western European countries that have applied cost-based or cost-oriented prices for both services. We have recently updated that benchmarking. Even though very different approaches have been taken across these countries to the detailed modelling or pricing components of these services (pricing principles and methodologies, common cost allocation, what national or sub-national markets are modelled) the aggregate price levels all ended up in a tight range.¹ Unless New Zealand is substantially different in respect of one or more material inputs into our modelling, it seems highly unlikely that any of the approaches mooted will lead to New Zealand prices that fall outside this range. We have seen no evidence to date that suggests there is any such fundamental difference.

Figure 1: wholesale copper cost based prices (NZ\$ per month)



¹ See body of submission for an explanation of benchmarking approach.

This suggests that the next stage of the Commission’s process – information gathering and finalisation of the inputs into TERA’s UCLL and UBA models, as well as the design parameters for those models – will be critical. All parties other than Chorus have indicated discomfort with the Commission’s proposed process for this stage (which affords no further consultation for industry participants prior to the draft determination). As we explained in our submission, we recommend the Commission add a consultation on key model parameters and information sources, and Commission emerging views prior to the draft decision in August.

Comments on other parties’ submissions

Submissions from all parties on the Commission’s UCLL and UBA FPP further consultation and supplementary paper agree that the Commission’s FPP task requires it to model forward-looking efficient costs for the UCLL and UBA services. However, there are significantly different views about:

1. The degree to which the Commission’s analysis of forward-looking efficient costs should be constrained by technical characteristics of the existing network; and
2. Whether the Commission should unpick the current aggregated approach to setting service prices.

In particular, Chorus argues that the efficient costs the Commission can model should be bounded by the description of the service set out in Schedule 1 or the STD. In other words, that the consideration of efficient costs is constrained by the existing technical capabilities or network design. It also seeks to re-litigate the question of whether the current geographically averaged approach to access network costs should be dis-aggregated and suggests, for example, that the “unbundled copper local loop network” component of the UBA price may be something different to the price for the designated access service that is called “Chorus’ unbundled copper local loop network” service.

We disagree with each of these assertions, which both seem to suggest the Commission is “required” to adopt nonsensical interpretations of the Act.

Whether efficient costs can be bound by the service definition

Tying the MEA tightly to characteristics of the current Chorus network and the way in which Chorus provides services today is unquestionably incompatible with the concepts of TSLRIC pricing and forward-looking pricing. It would prevent the Commission from considering network architectures, for example, such as FTTH and fixed wireless, that we know operators are investing in today, and which support services that consumers see as realistic substitutes for copper based services.

It seems to us that, in this respect, Chorus is asking the Commission to do the very thing it asserted the Commission did in its IPP benchmarking, that is, to artificially bookend its assessment of efficient costs in a way that prevents the Commission from giving any meaning to the TSLRIC definition in the Act, or meeting the efficiency standard implied by it.

Chorus' line of argument effectively requires the Commission to apply a rate of return approach to a revalued version of Chorus' legacy network. It misconstrues the purpose of a TSLRIC exercise and price, and renders the use of a TSLRIC pricing principle meaningless. We would therefore argue that such an approach is not available to the Commission.

Whether layer 1 local access prices should be dis-aggregated or aligned

Dis-aggregating the prices for similar services which all use Chorus' unbundled local loop network would directly contravene the requirement in clause 4A of schedule 1 to geographically average key regulated input prices. It would also render the regulatory access framework set out in the Act unsustainable, and create an immediate need for at least two schedule 3 reviews. Here, it seems to us, Chorus is asking the Commission to consider an interpretation of the Act that renders that Act untenable.

A far more coherent and supportable interpretation is one that results in aligned pricing for all similar regulated layer 1 services that utilise the local access network: the price for UCLL is the same as the price for UCLF; is the same as the price for the unbundled copper local loop component of the UBA price, and is the same as the price for SLU+SLU Backhaul. This interpretation gives sensible meaning to clause 4A and creates sensible and consistent incentives for access seekers which support that current construct of the regulatory access framework set out in schedule 1.

The way forward

There are divergent views amongst submitters over the core purpose of the FPP exercise. Ironically, the debate over the purpose and MEA may not matter in practice. We agree with Chorus that a copper or fibre MEA may not make much difference to cost as they likely share similar civil engineering costs.

There is also alignment amongst RSP submitters that the Commission should model multiple technologies to ensure that it is able to properly identify the lowest cost platform, and fixed wireless/mobile networks should form part of the MEA. Therefore, we recommend that the Commission:

- Ask it's consultants to develop models for copper and FTTH networks, with a wireless cap. It may be that costs are similar and no decision is required or, if there are material differences, the Commission is then able to make a decision. While the timing was unclear, TERA indicated at the workshop that this was possible and we understand its approach taken in Denmark;
- Extend the scope of its investigation into the likely costs of deploying a modern network in New Zealand to include relevant information from LFCs and line companies which have in fact recently deployed telecommunications networks and adjacent infrastructure; and
- As recommended in our submission, add a consultation on key model parameters and information sources, and Commission emerging views prior to the draft decision in August (even if it extends the draft decision timing beyond September).

Once we have a first draft of the model, we will be in a position to address the key differences (and it may be that some differences are simply not that relevant).

However, the ongoing debate over MEA technologies does identify the need for a clearly articulated understanding of the purpose of these FPP processes, which the Commission could then apply consistently to help guide it in making the many decisions it will have to make through these processes. We agree with Vodafone that the Commission needs to set out what it believes the FPP purpose is, and then how the MEA supports that purpose. This will resolve many of Chorus and Callplus' questions.

Other matters

Price expectations. Chorus has again incorrectly suggested that Telecom forecast a UBA cost of \$17 - \$21 (over and above the UCLL price), suggesting there has been a changing over views over time [footnote 1 of submission]. In the relevant Telecom submission, from August 2012, we explicitly stated that this figure was our estimate of UBA costs for the **highest costing 25% of lines** (where competition from UCLL and other providers was unlikely) rather than our views of nationally averaged costs.

Introduction

1. Thank you for the opportunity to comment on submissions relating to the Commission's UCLL and UBA FPP further consultation and supplementary papers.
2. In this submission, we comment on the differing views outlined in submission on:
 - a. The FPP outcomes and purpose of the MEA;
 - b. Price alignment across the services supported by the local access network; and
 - c. A number of secondary and process matters.
3. We have also asked Russell McVeagh to consider the matters raised in the Chapman Tripp memorandum attached to the Chorus submission. A memorandum is attached.

FPP outcomes and the MEA

4. Across submissions there appears to be agreement that the UCLL and UBA costs modelled by the Commission need to be forward looking and efficient. However, there are significantly different views over whether consideration of efficient costs should be bounded by technical aspects of the current service.
5. In the end, these differences come down to differing views as to the purpose of the FPP and the role of the MEA in supporting that purpose.

The Commission should not bound its consideration of efficient costs

6. Chorus in particular seeks to constrain the assessment of efficient costs by mechanistic referencing to existing services and technologies deployed.
7. Chorus suggests that the service description set out in the STD bounds the scope for consideration of efficient prices and that the Commission is required to replicate the functionality of the service and cost of the service defined in the STD [9]. It then concludes that the MEA must be capable of delivering the full functionality of the STD service, and the Commission does not have the discretion to model a service based on the core, or some, functions of the STD service [58, 61]. The practical application of this approach is that the Commission can only identify Chorus' costs (rather than efficient costs) and cannot therefore give any real meaning to the words of the TSLRIC definition or the well-understood meaning of TSLRIC pricing exercises.
8. Alternatively, Orcon/Callplus suggests that the Commission is required to replicate the network path implied by the service definition and extend only as far as the DSL capable part of the current network [1.5, 2.11, 3.1-4.9]. In other words, Orcon/ Callplus recommend constraining the scope of the service against which efficient technologies can be applied.
9. Bounding the scope of "efficient costs" by the characteristics of legacy deployed technologies or network design is unquestionably incompatible with the concept of TSLRIC pricing.

10. In the end, both proposals reflect a rate of return approach to setting prices, which requires a different set of legislative provisions to what we have under the Telecommunications Act.
11. Under a rate of return approach, regulated prices seek to compensate the service provider for the efficiently incurred costs to provide the service, i.e. the focus is compensation for the provider's efficiently incurred costs and prudent investment.
12. The TSLRIC based approach set out in the Telecommunications Act sets a different focus. It seeks to provide efficient signals to providers, access seekers and consumers, i.e. promoting efficient investment, use of existing infrastructure and consumption.² If we were to reflect these together into a single simple policy objective underpinning the UCLL pricing principle, it would be that setting prices on the basis of forward looking costs is expected to generate outcomes consistent with what we would see in competitive markets, and best promote the long term interests of end users.
13. The Commission is tasked with identifying the efficient forward looking costs that deliver the FPP outcomes. These are not determined by the incumbent operator or the existing service definitions, but by the hypothetical efficient network that could deliver the expected outcomes of competitive markets. Tailoring the model too tightly to a particular provider – whether that be Chorus or a new entrant – undermines the efficient cost signals of the TSLRIC standard.
14. Therefore, the Commission needs a means of abstracting away from legacy path-dependent and inefficient costs. The MEA is a tool for understanding what efficient costs might be in the New Zealand environment. The Act does not require the Commission to adopt a particular MEA, although the MEA chosen should seek to identify the costs that will provide efficient investment and consumption signals, i.e. the expected outcomes of a competitive market. The MEA shouldn't be developed or applied mechanically or divorced from the desirable FPP outcomes.
15. The difficulty with Chorus' and Callplus' proposed approaches is that, by tying the MEA tightly to characteristics of the current Chorus network and the way in which Chorus provides services today, it artificially bounds the scope for Commission's assessment of efficient costs. This means the Commission can't set a price that best reflects FPP or section 18 outcomes.
16. The Commission would not be able to consider options, for example, such as FTTH and fixed wireless, when we know these are the forward looking technologies that operators are investing in and which support services that consumers see as realistic substitutes for copper based services. More importantly, over time, FTTH is the replacement platform for the copper network and needs to be reflected in modelling. It seems to us that Chorus is asking the Commission to do the very thing it asserted the Commission did in its IPP benchmarking - bookend its assessment of efficient costs.

² Discussed more fully in our February 2014 submission.

17. If the Commission were to limit itself in the way proposed by Chorus, it would arguably be artificially “bookending” the scope of its enquiry, and accordingly its obligation, to identify the efficient costs for providing a competitive service. If it does so and fails to properly identify the range of efficient costs that would be incurred on a forward looking basis it would not properly conduct a TSLRIC pricing exercise nor give best effect to section 18.
18. While we believe that a FTTH MEA is likely to be preferable, we agree with RSPs that the best way forward is for the Commission’s consultants, Tera, to produce two separate copper and FTTH costs models, with a wireless overlay as we understand TERA did in Denmark. Once those models are completed and the costs known, the Commission should then select the lowest cost model because this reflects the most efficient costs of supplying the relevant service(s).
19. We further agree with RSPs [for example Orcon/Callplus at 7.21] that the modelled technologies should reflect what is practical in a real world situation, and all the technologies being discussed are well established and in large scale deployment – none would be considered “cutting edge” or nascent. Internationally, the OECD reported in June 2013 that there are over 52 million fibre and over 850 million wireless broadband subscribers.³ While closer to home, UFB deployment continues with over 360,000 end users able to connect to UFB fibre.⁴ Mobile operators are rolling out 4G/LTE networks – the 4G/LTE standard is designed to support broadband services.⁵ If RSPs wanted to push the bounds of technology today, we would be asking the Commission to consider emerging technologies such as Fibre to the distribution point and 4G/LTE carrier aggregation which promise even lower costs and improved broadband services.⁶

Applying the IM principles demonstrates the difficulties in Chorus’ proposed approach

20. The Callplus and Orcon submission raises a number of parallels to the IM process, which we agree are pertinent. Setting the proposed approach in the context of IM principles illustrates the difficulty of Chorus’ proposed approach.
21. Generally, regulators seek to maximise consumer outcomes by setting efficient prices, i.e.:
 - a. To reflect costs that would be incurred by an efficient provider of the service;

³ See OECD Broadband Statistics Update Jan 2014 <http://www.oecd.org/sti/broadband/broadband-statistics-update.htm>. Also see iDate December 2013 European review http://www.ftthcouncil.eu/documents/Reports/2014/Market_Data_December_2013.pdf.

⁴ <http://www.med.govt.nz/sectors-industries/technology-communication/fast-broadband/pdf-and-documents-library/ultra-fast-broadband-initiative/broadband-deployment-update-1-october-to-31-december-2013-776-kb-pdf/view>

⁵ The LTE standard is specifically intended to support mobile broadband services <https://sites.google.com/site/lteencyclopedia/home>.

⁶ BT is currently trialling Fibre to the Distribution Point (while supporting very high speeds, the technology allows operators to avoid replacing high cost or difficult lead-ins) see <http://www.ispreview.co.uk/index.php/2013/10/bt-confirm-uk-plan-trial-1gbps-capable-g-fast-fttdp-broadband.html>. Carrier aggregation enables spectrum to be used across multiple bands <http://www.3gpp.org/technologies/keywords-acronyms/101-carrier-aggregation-explained>.

- b. To ensure that the provider has sufficient revenue to maintain service capability or financial capital intact; and
 - c. To minimise distorting either consumption or investment decisions.
22. In the case of our Act, we've characterised this as the Commission achieving these objectives by seeking outcomes consistent with those produced in workably competitive markets - efficient prices, normal returns and limited supplier ability to extract excessive profits. This is because prices based on this approach will provide efficient investment and consumption. However, the forward looking costs that deliver these outcomes are not Chorus' actual costs, but rather those of an efficient provider not encumbered by Chorus' past inefficiencies and technologies, deploying the lowest cost technology available to it. Therefore, the Commission needs a means of assessing what these costs are – the MEA.
23. This is consistent with the Court's IM approach. The Court noted that, for existing assets and capability, as long as the asset value was set above scrap value the provider would rationally keep the assets in operation and operate them as efficiently as possible [598]. While low prices ensure some potential users are not priced out of the market and assets are not systematically under-used, this needs to be balanced with investors' need to recover total costs and the importance of wider regulatory signals [602-603, 605].
24. In terms of new investment, the Court further concluded that the value of existing assets had little or no impact on incentives for the supplier to innovate and invest in new or replacement assets [604]. In the IM context, new investment incentives would be provided by the roll-forward provisions whereby efficient future investment is added to the regulatory asset base.
25. If the Commission was to take a similar approach here, the starting point is the minimum asset value that maintains Chorus' financial capital intact. This is the minimum price (minimising the number of consumers that are priced out of the market), while recognising that providers have invested in infrastructure and this should not be ignored. The only logical justification for setting asset values (and prices) above this minimum level, would be in anticipation of future investment to maintain the service capability intact and encourage innovation.
26. This illustrates the contradiction in Chorus' proposed approach. Chorus' proposed approach – referencing existing copper platforms and full replacement – will result in asset values significantly above that necessary to maintain financial capital intact, yet bear no relationship to forward looking investment we expect to see. Operators are deploying fibre networks taking advantage of existing and unlikely to be replicated civil infrastructure.
27. In other words, if the Commission were constrained only to adopt an MEA that mirrored the current network (as Chorus suggest), then it would be impossible for the MEA to provide efficient pricing signals. Accordingly, the Chorus view of MEA has no purpose in an FPP process. The only option available to the Commission would be to revert to the minimum implied by capital maintenance value, adjusted to reflect anticipated efficient investment over the regulatory period (for example, by building in to the asset base a forecast of efficient investment over the regulatory period).

28. Further, as the valuation methodology is divorced from possible future investments, the Commission has no evidence on which it could adopt an incentive based valuation. We believe the Commission would require probative evidence showing anticipated future investment or innovation for it to depart from a minimal capital maintaining value.
29. The Orcon/Callplus approach suffers from the same fate. While Chorus seeks to constrain the consideration of efficient costs, Orcon/Callplus adopts a similar approach to constrain consideration of the scope of the efficient costs and allocation of common costs.

Chorus' technical arguments

30. As noted above, the Commission shouldn't be constrained in its MEA discretion beyond that required to meet the objectives of the FPP.
31. This means that the MEA should both reflect the technology options available to efficient service providers and the reasonable alternatives available to RSP and end users. We recognise that Dr Every-Palmer's core functionality approach is a reasonable way to capture these options and consistent with good regulatory practice.
32. However, Chorus proposes additional technical requirements that would significantly constrain the MEA choice and its usefulness as a means of understanding efficient costs. Even if the MEA choice could be constrained in this way, Chorus' proposed limitations are not evident in practice. These are discussed below.

References to "facilities and functions" limit the assessment of efficient costs

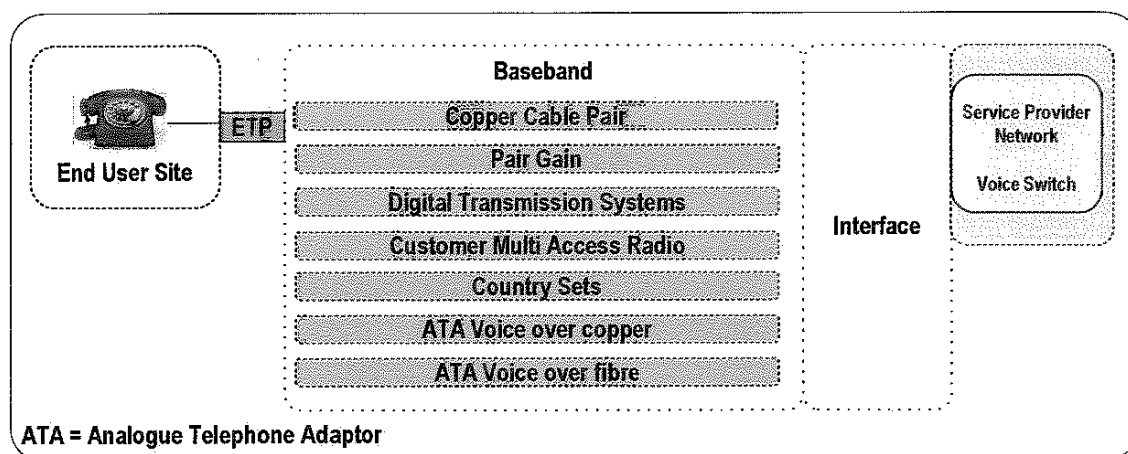
33. Chorus suggest that the reference to "facilities and functions" in the TSLRIC definition constrains the assessment of cost to the STD service [11]. We don't believe the definition supports this interpretation. The reference to facilities and functions:
 - a. In terms of identifying TSLRIC costs, refers to the facilities and functions of the modelled network rather than the facilities and functions of the STD service. The use of the term "service provider" rather than "access provider" is instructive in clarifying that the facilities and functions in question are not those of the existing access provider's service;
 - b. Must be read in conjunction with the definition of forward-looking costs, which sets an efficiency standard and again, references this standard to a "service provider" rather than the "access provider"; and
 - c. Is clarified by the preceding requirement that the Commission take a "forward looking... in the long run" perspective. These words by definition must suggest consideration of different technologies.
34. Read correctly, the definition requires that the Commission determine the forward looking costs in the long run of all the facilities and functions of an efficient service provided by an efficient service provider – not those of the existing access provider.

References to TSO obligations

35. Chorus also notes that Chorus' access network is designed to meet detailed TSO requirements. As a result, it suggests that the Commission is required to choose an MEA that is capable of meeting what Chorus describes as "detailed TSO requirements", or failing that, that a number of "corrective measures" would be required to a FTTH or fixed wireless network to enable it to support a variety of low-speed data services currently supported by the PSTN [ref]. A number of services rely on copper based services and it still receives requests to provision copper to new apartments and subdivisions and maintains copper, even when fibre is available [15-16].
36. Chapman Tripp also suggest that it would be inconsistent with an overall legislative intent or expectation if the FPP analysis involved assumptions about technology which were inconsistent with, or assumed away, the ability of the service providers to comply with the TSO.
37. We disagree. The TSO captures general service obligations and is not technology specific as suggested by Chorus. Chorus' TSO obligation is to deliver a "TSO network service" that enables Telecom to meet its TSO obligations. "TSO network service" is defined as:⁷

...the Baseband service provided to Telecom...

...Baseband provides an analogue voice path...from the customer premises to a service provider using a range of technologies, as shown below



38. Further, Chorus' TSO Deed expressly permits Chorus to change access technology at any time, without limitation, with acknowledged impact on delivery locations and interfaces (and with consequent flow-on effect for the retail services that it might be capable of supporting):

Changing access technology

⁷ Telecommunications Service Obligations (TSO) Deed for TSO Network Service, p13

Chorus will provide notice to service providers of a change in voice technology at a given site, and work with affected service providers to manage the migration.

Changing access technology will probably result in a change of delivery location and interface options.

39. The low-speed data services and other service characteristics Chorus argues must be considered part of the service functionality for MEA purposes are, almost without exception, not required to be provided by either Chorus or Telecom under existing TSO Deeds. To the extent they form part of the expected service set for customers, fibre network providers and retail service providers are already identifying solutions, or replacement services, that are compatible with fibre and mobile technologies.
40. In any case, Government policy, providers, consumers and market are already looking forward and we should expect the TSO – over time – to do likewise. In fact, the FPP requires a forward looking perspective. For example:
- a. The Government decided at the time of separation that, in addressing the implications of FTTP deployment, the local service retail TSO should set out high level technology neutral outcomes [75b of cabinet paper] and provide for a process for the approval of new specified TSO retail services that met general performance requirements [76].⁸ Government policy is that TSO services can be provided over fixed copper and fibre, and wireless networks. . [

]TCNZCI;

- b. Telecom is the only RSP that offers a TSO option, and TSO customers form a small part of our customer base [

]TCNZCI.;

- c. Chorus, itself, is focused on fibre deployment. Copper based TSO services are not available to all premises and a number of sub-divisions are already served solely by fibre. [

]TCNZCI. Further, Chorus has announced that intends it will minimise investment in copper infrastructure;

- i. Under revised connection policies note whereby, in addition to the \$155 charge to install a lead in, it will charge a further \$195 for a new dwelling (first time connection to the network). These charges are for a copper service lead in up to 100 metres (in to an open trench where relevant), plus plus time and materials for any additional distance [20 February 2014 Informer]; and

⁸ See Regulatory Impact Statement <http://www.parliament.nz/resource/0000171267> and 13 December 2010 Cabinet paper.

- ii. Minimising pro-active network investment.⁹ [

] TCNZCI

Fibre unbundling

41. Chorus further notes, for completeness, that neither the current GPON build nor fixed wireless access is capable of providing an unbundled layer 1 service with dedicated connectivity equivalent to UCLL or SLU [19].
42. However, it must be possible to provide such a service because Chorus has agreed with the Crown to provide both a layer 2 UFB service and design and build the network to support layer 1 unbundling from 2020.¹⁰ We are not aware of technical limitations that, in itself, would prevent GPON from being unbundled.¹¹ An unbundled fibre service is not only possible but likely to be in existence by 2020. We therefore consider that the Commission is entitled to recognise a layer 1 fibre MEA and must in fact use such an assumption in its modelling if a fibre MEA is the most efficient forward-looking choice.

Conclusion on the MEA: the way forward

43. From submissions, the RSPs appear to agree that the MEA should seek to reflect the lowest cost means from providing the service. This likely means a FTTH network with a wireless cap, in much the same way as applied in the TSO processes.
44. Chorus proposes a copper (FTTN) network, but acknowledges that common civil engineering costs mean that fibre and copper costs may not be substantially dissimilar [82]. We agree it is unclear how significant the differences in cost will be. In all cases, the Commission should ensure that two models (a copper and fibre) are produced to ensure that the lowest cost model can be selected.
45. This is an area where there are significantly divergent views. As a practical way forward we recommend that the Commission:
- a. Model multiple networks as proposed in submissions to enable a clear decision to be taken on the lowest cost MEA. In which case, it would move to obtain information that

⁹ For example, see Chorus Half Year Result 2014 presentation <http://www.chorus.co.nz/file/42818/Investor-Presentation.pdf>.

¹⁰ See section 6 of Chorus Fibre Deed.

<http://www.crownfibre.govt.nz/media/17297/chorus%20limited%20deed%20of%20open%20access%20undertakings%20for%20fibre%20services.pdf>

¹¹ On the face of it, a number of options appear to have been explored. For example, the Analysis Mason report for Ofcom sets out a number of unbundling options

[http://stakeholders.ofcom.org.uk/binaries/research/technology-research/Analysys Mason GPON Market 1.pdf](http://stakeholders.ofcom.org.uk/binaries/research/technology-research/Analysys%20Mason%20GPON%20Market%201.pdf).

would enable it to model both a FTTH and FTTN networks (we understand much of the same data – for example, premises locations and trenching costs – will be used for each model), and to apply a wireless cap in the same way as it did in the TSO process; and

- b. As Vodafone suggests, sets out its framework - the key FPP objectives and MEA role in supporting those objectives - and from that we can answer a number of Chorus and Callplus' questions [C25]
46. As set out in our submission, we believe the Commission would be wise to add a consultation on key model and information sources, and Commission emerging views prior to the draft decision in August (even if that extends the draft decision timing beyond September).
47. Irrespective of the approach taken by the Commission, we agree with Orcon/Callplus that the Commission should seek information from other LFCs and line companies on the costs to deploy fibre networks.

Price alignment

48. Submissions on the Commission's Further Consultation evidence a wide range of views on the question of whether, and if so how, the Commission can align prices across the UCLL, SLU, UCLF and UBA services. Submitters broadly fall into two camps:
- a. Those who contend that each STD should be priced with reference solely to the forward-looking costs of the precise network elements that service utilises (we term this "dis-aggregated pricing"); and
 - b. Those who contend the Act permits, and indeed directs, the Commission to calculate a single price to apply to all of these services, being the forward-looking cost of the unbundled copper local loop network, of which all of these services form a part of, and/or use.
49. While it is clear the Act might have benefitted from clearer drafting in respect of this question, it seems equally clear to us that the latter is the only interpretation of the Act that can deliver a coherent and sustainable regulatory framework and so must be preferred. That is, the price of the UCLL service should be the same price as the price for the UCLF service, for the component of the UBA pricing principle that is described as "the price for Chorus' unbundled copper local loop", and for the aggregate price of the SLU + SLU backhaul services.
50. In his advice to the Commission on this question, we interpret Dr Every-Palmer's advice to be that:
- a. The price determined for each STD service may be the same price;
 - b. Differential unbundling prices depending on whether a line is unbundled or not will create incentives to cherry-pick and this requires the Commission to give consideration to shifting all services (UCLL/UCLF/UBA) to a de-averaged tariff structure (which would require schedule 3 reviews of the UCLF and UBA service descriptions);

- c. Aligned prices may be more consistent with the statutory intention evidenced by clause 4A; and
- d. If pricing distinctions are to be removed, the Commission will need to consider whether it is the SLU price that is comparable to the UCLL/UCLF price, or whether it is the aggregate of the SLU + SLU backhaul prices.

51. We concur with Dr Every-Palmer's analysis in each respect:

The price determined for each STD service may be the same price

52. There are a number of reasons that might lead the Commission to determine an identical price for separate services that are either within the same designated access service, or entirely separate designated access services:

- a. In the first instance, the Act may explicitly direct the Commission to do so, for example:
 - i. the UCLF pricing principles explicitly direct that the UCLF price should be the price for "Chorus' full unbundled copper local loop network" (which we interpret to be a reference to the exchange-based or full unbundling STD set for the designated access service titled Chorus' unbundled copper local loop network);
 - ii. the UBA pricing principles direct that the UBA price should be the *price* for Chorus' unbundled copper local loop network – which we interpret to be the designated access service of that name – plus additional UBA-specific costs;
 - iii. Clause 4A of Schedule 1 directs that prices for the UCLL and UBA designated access services must be geographically averaged. The clause does not limit its application to individual STDs, but is expressed to apply across the entire designated access services. In doing so it directs the Commission to apply a price alignment across multiple STDs that may operate from time to time under the auspices of the designated access service. To provide a simple example, let us imagine that there existed two separate UCLL STDs – one for urban areas and one for non-urban. In that case, clause 4A would direct that the price for each of these STDs must be the same. The same must be true for two separate STDs covering cabinetised and non-cabinetised lines (which is just another form of geographic differentiation);
- b. In the second instance, the Commission's application of a TSLRIC exercise may lead the Commission to the conclusion that the forward-looking price of the services in question converges or is identical, for example:
 - i. In a FTTH network the absence of active cabinets means there is absolutely no (or at best very little) difference between the costs for the layer 1 services that utilise the network elements between exchanges and end-user premises;

- ii. Whatever the network architecture used, in building a forward-looking cost model the Commission may conclude that the difference in forward-looking costs for the UCLL, UCLF, UCLL component of UBA, and SLU + SLU backhaul is in very large part determined by arbitrary allocation decisions for the significant common costs (trenches) shared by these services, and that the impossibility of getting that allocation 100% correct militates towards a conclusion that all should share those costs equally;
- c. In the third instance, the Commission may determine that doing so best gives effect to the s18 purpose statement, for example:
- i. A disaggregation of prices will inevitably lead to overwhelming incentives for access seekers to undermine the regulatory framework completely by cherry-picking. It must be open to the Commission to determine that this outcome would not best give effect to the s18 purpose statement, and instead prefer a coherent and consistent price alignment that delivered a sustainable regulatory framework consistent with the policy objectives described at the time the Amendment Act was passed;
 - ii. In particular, in considering the UCLL pricing principles, policy makers recognised the core Government policy principle that voice services be geographically averaged [31 of RIS] and the need for (averaging) consistency through the value chain to avoid unnecessary market distortions [34 of RIS]. The December 2010 Cabinet paper went further in noting that consistency through the value chain was essential in the event of structural separation [38-39 of paper]. Policy makers acknowledged a potential lessening in UCLL based competition, but mitigating actions - the availability of cost based UBA, three year transition period and benefit of investment in superior retail UFB services rather than further copper based investment - would mitigate the potential impact on end users [43, 49 of paper].¹²

Policy makers clearly had in mind the importance of maintaining consistency through the value chain (layers of services) and objective to maintain averaged retail prices. As explained in our earlier submission, disaggregated prices would inevitably flow through to retail prices as RSPs migrated on to the lowest cost input for a particular access.

Differential unbundling prices depending on whether a line is unbundled or not will create incentives to cherry-pick and this requires the Commission to give consideration to shifting all services (UCLL/UCLF/UBA) to a de-averaged tariff structure (which would require schedule 3 reviews of the UCLF and UBA service descriptions);

¹² See December 2010 Cabinet paper. Cabinet paper analysis was reiterated in the RIS at 37, 43, 45-56.

53. It is quite clear in the act that the UBA and UCLF prices must be geographically averaged and based on a geographical average of UCLL and SLU costs. If the UCLL and SLU prices are to be set in a dis-aggregated way our entire regulatory framework becomes unsustainable because this mixture of dis-aggregated prices and averaged prices will by definition enable access seekers to cherry-pick the lowest cost option in every case. It also makes the Commission's task of considering relativity between the UBA and UCLL designated access services practically impossible.
54. This situation would necessitate schedule 3 reviews of either: (a) the UBA and UCLF designated access services - to de-average their price; or (b) the UCLL and SLU Backhaul designated access services - to average them.
55. Those parties that argue for dis-aggregated pricing are suggesting the Commission is required to adopt an interpretation of the Act that renders that same Act untenable and requires immediate amendments to it.

Averaged prices may be more consistent with the statutory intention evidenced by clause 4A

56. Clause 4A of Schedule 1 states:

In applying the ...final pricing principle for the following designated access services, the Commission must determine a geographically averaged price:

- (a) Chorus' unbundled bitstream access service;
- (b) Chorus' unbundled copper local loop network service.

57. Clause 4A was part of an explicit policy decision by Government to depart from the previous de-averaged pricing framework we had operated under prior to the 2011 Amendment Act. At the same time, geographically averaged fibre access prices were agreed as part of the Government's UFB initiative.
58. The previous de-averaged pricing framework was defined by reference to urban/non-urban demographics. The dis-aggregated pricing that Chorus and CallPlus appear to support would be defined by reference to cabinetised/non-cabinetised network architecture. This is just another form of geographic de-averaging, which has exactly the same de-averaging effect of the previous urban/non-urban de-averaging. Both must be precluded by clause 4A if that clause is to be given any real meaning.

If pricing distinctions are to be removed, the Commission will need to consider whether it is the SLU price that is comparable to the UCLL/UCLF price, or whether it is the aggregate of the SLU + SLU backhaul prices

59. Each of these options is open to the Commission.

60. The Commission could choose to align the UCLL and SLU prices in order to set a geographically averaged price for unbundled copper local loops at the nearest copper concentration point to the end-user premises. Whatever backhaul is required to access those concentration points will depend on the circumstances – some exchanges are co-located with Chorus NAPOLs or Pops, some exchanges are one or two hops from the NAPOL, just as some cabinets will be connected directly to a NAPOL, whereas some will be connected to an exchange that is itself a further hop to a NAPOL.
61. Equally, the Commission could determine that SLU + SLU backhaul – which together span the exchange to end-user premise as UCLL itself does – are a closer “equivalent” to UCLL and that it should be the aggregate of those prices that is aligned with the UCLL price. This approach would also necessitate the calculation of a per-line SLU backhaul price, which will be different to the current regulated SLU backhaul price.
62. The best approach is likely to be determined by the allocation of shared trenching costs between layer 1 and 2 services. If the large proportion of the cost of the trench between the cabinet and exchange is allocated to other services (UBA for example) then there may be little difference between these two options. That said, at least conceptually, we prefer the view that the UCLL price should be aligned with the aggregate of the SLU + SLU Backhaul prices, and the SLU backhaul price revisited. That would give a single price for the unbundled copper local loop network (exchange to end-user premises) which is more consistent with an efficient MEA and provides a more stable upon which the rest of the regulatory framework can sit.

Other matters

Claimed price expectations

63. Chorus has again incorrectly suggested that Telecom forecast a UBA cost of \$17 - \$21 (over and above the UCLL price), suggesting there has been a changing over views over time [footnote 1 of submission]. In the relevant Telecom submission, from August 2012, we explicitly stated that this figure was our estimate of UBA costs for the **highest costing 25% of lines** rather than our views of nationally averaged costs.¹³
64. In reality, no one knows what prices might come out of the current UCLL and UBA price reviews. The best indication of cost based prices we have is likely to be the rudimentary benchmark of UCLL+UBA prices we included in our September 2013 submission to Government.
65. That benchmark comprised a rudimentary comparison of observable nationally averaged UCLL+UBA regulated copper prices from a range of broadly comparable countries. While the sample is far from an exhaustive scientific benchmark, we believe it does provide a directional guide of where total copper prices might be expected to sit.

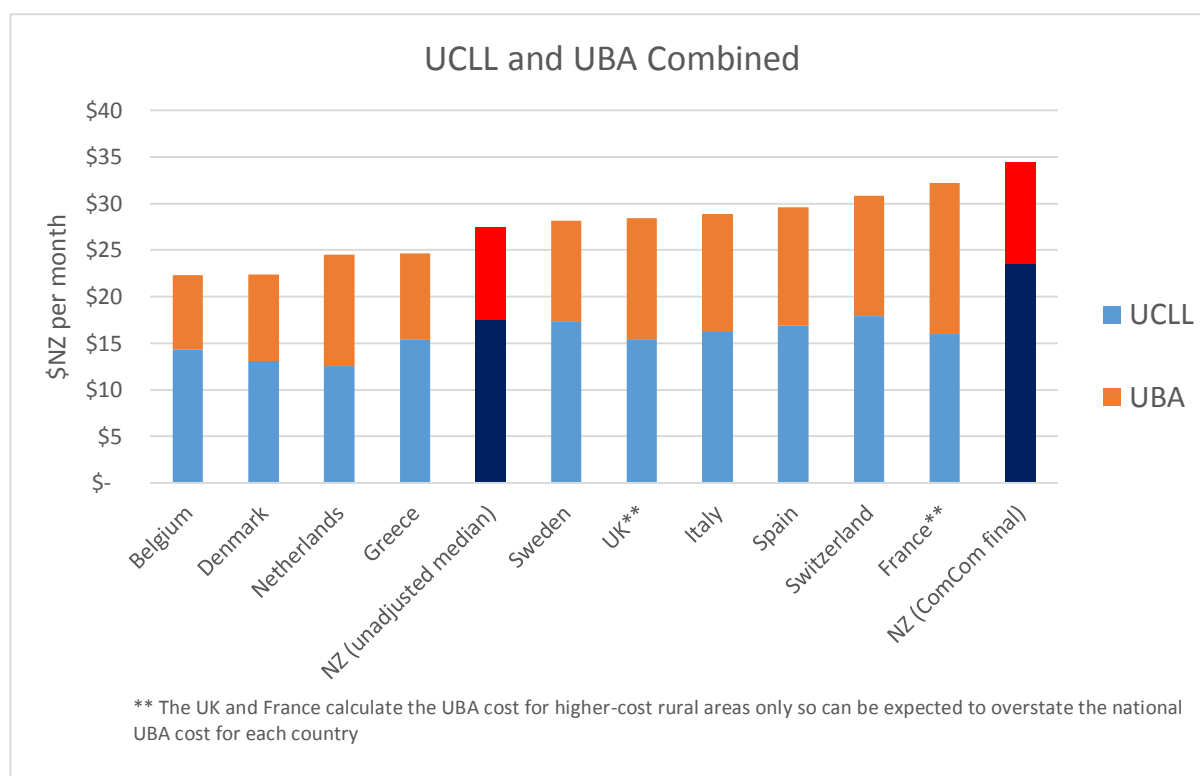
¹³ <http://www.comcom.govt.nz/dmsdocument/8190>

66. We have updated our September 2013 benchmark data points, using updated published prices in circumstances where prices have been updated by regulators. These prices all reflect a greater or lesser degree of cost orientation and have had a level of regulatory scrutiny. Although the UBA equivalent prices for the United Kingdom and France are not nationally averaged prices, but apply only to non-competitive subnational (rural) market areas, we have included those for reference. We have omitted UBA equivalent prices set using some form of retail minus pricing approach (e.g. Portugal or Ireland), or based on a price squeeze test (e.g. Austria or Germany). The benchmark data points illustrate the combined UCLL and UBA equivalent services to minimise bias due to cross-country differences in service definitions. This material is compared with two New Zealand observations – first, the risk adjusted value using the IPP prices set for both services by the Commission, and second, the unadjusted value represented by the raw benchmark derived by the Commission for UCLL before making the indexing and econometric adjustments together with the IPP benchmark unadjusted median price for UBA.

67. The updated observations suggest that:

- a. The price of the combined total UCLL plus UBA service would, based on a variety of jurisdictions that have implemented forward looking UCLL prices, sit in a conservative range of \$25-\$35. New Zealand would need to be substantially different in a material input to fall outside this range; and
- b. While different approaches might be taken to the allocation of large common access network costs across services, pricing principles, statutory purposes and policy objectives, the overseas regulators who have looked at this have all ended up in a tight range. Therefore, the key differentiator may be how common costs are allocated across these services.

Figure 1: wholesale copper cost based prices (NZ\$ per month)



Backdating

68. Chorus proposes that the Commission backdate the FPP prices to the date the IPP prices came in to effect [169]. The Court of Appeal in *Telecom New Zealand* made it clear that, at least in the absence of some truly extraordinary countervailing considerations, backdating is required [169-170 in referring to the supporting Chapman Tripp memorandum].

69. However, consistent with the advice in the attached memorandum by Russell McVeagh, we consider the Commission has the discretion whether or not to back date revised prices. As a matter of legal principle, Chorus' proposed approach does not move us beyond the normal position that:

- a. The Commission must apply relevant statutory provisions and act consistently with its statutory powers; and
- b. When considering how to apply or interpret its statutory powers, the Commission must consider whether there is court guidance on how to properly do so. That will require careful consideration of the scope and extent of a court's decision.

70. In our view there is no authority for the argument in the CT opinion that the Commission must place a greater weight on a judicial opinion that was obiter to the question before it, and relates to a legal regime that is different to what the Commission is making a decision under today.

71. The Commission will need to balance a range of considerations relating to, amongst other things: the wording of the Act, the Court of Appeal has clearly stated that an FPP price should be treated as being more efficient than the IPP price it replaces, and whether backdating is consistent with section 18 in all the circumstances (as set out in the JEP Advice).
72. We think that it is instructive that in the (very different) process before it at the time the Court of Appeal considered that a lower price could be assumed to be more efficient and, accordingly, best give effect to the section 18 purpose. By contrast the Court considered that the ability to delay the implementation of the lower price would not best meet the section 18 purpose. The way in which backdating or delaying the implementation of a price would give effect to section 18 appears to be the touchstone for consideration.
73. Vodafone sets out a number of additional considerations relevant to a decision whether to backdate an FPP price [F6]. We agree with Vodafone that, if the Commission were to decide to backdate, backdating a higher price will have greater distortionary and competitive impact than backdating lower prices. In short, competitive retail markets means that increased input costs will likely reduce the intensity of RSP competition, while unlikely to lead to any additional Chorus innovation or investment. Conversely, competition at the retail level means that any price reductions will ultimately be passed to consumers as better services or lower prices.
74. Chorus is willing to work with the Commission on payment options to, for example, implement a payment schedule whereby customers paid an additional amount to the monthly rental over say 5 years. We generally support glide paths as a means to mitigate the impact of material price change (noting that the Act already provides for a 3 year transition period in this case). However, Chorus' proposed approach will likely have the effect of holding inefficient prices for an extended period. The Commission would need to consider the relative benefits what is, effectively, a financing facility against the distortion of higher prices, and whether it would be more efficient to simply determine not to backdate in the first instance.

Relativity

75. Chorus note that the Commission is tasked with considering relativity between UCLL and UBA prices and that the Commission must, therefore, turn its mind to additional considerations to that it would otherwise consider when applying TSLRIC [138, 151].
76. While it is clearly the case that relativity between UCLL and UBA is a mandatory relevant consideration, it is less clear what this consideration should mean or, if the price for UCLL and UBA are both set using TSLRIC, what further adjustment may be required to give effect to the relativity consideration.
77. As Russell McVeagh note in the attached memorandum, the High Court recently decided that, in the context of section 18, it will not always be the case that a mandatory relevant consideration will have an observable impact on every decision made by the Commission. In that case, it was because the decision in issue was essentially evidence-based that it was not susceptible to adjustment on section 18 grounds. Similarly, the Commission could decide that

prices determined under TSLRIC are not susceptible to further adjustment on relativity grounds.

78. In other words, the Commission is not required to create further meaning or adjustment by the existence of a S18 consideration in itself.
79. Chorus suggest that the legislative intent of the relativity consideration seems to require the Commission to consider whether its pricing decisions are consistent with the ladder of investment (**LOI**). That is, access seekers have an incentive to migrate from the UBA to the UCLL rung of the ladder [147-148].
80. The LOI is not specified in the Act and it is difficult to see its place in today's policy framework. Clearly, a LOI framework formed part of policy considerations for the 2006 reforms. However, even if the ladder of investment theory itself is still seen as having merit,¹⁴ the evidence suggests it has little relevance for today's 2011 framework.
81. The Commission is required by the Act to estimate efficient TSLRIC prices for services through the value chain. Where the Commission has limited if any ability to depart from the FPP standard, it is difficult to see what place the LOI can have in considerations beyond a reminder to focus on efficient costs.
82. Further, policy makers have moved on from the 2006 reforms. At the time of the 2011 amendments, policy makers were conscious that the proposed policy approach challenged that set in 2006 [RIS at 18]. In particular, the increase in UCLL prices for access seeker was expected to have detrimental impacts and create disincentives to carrying out further unbundling in urban areas [RIS at 37, 42]. Accordingly, transitional arrangements – i.e. maintaining geographically differentiated UCLL prices, freezing UBA prices and prohibiting Telecom from purchasing UCLL until three years from separation day – were seen as important to enable access seekers and Chorus to adapt their business models to reflect new price levels and recover their sunk investments [RIS at 46-48].¹⁵
83. As noted in our submission, we believe that relativity requires that the Commission ensures a consistent approach is taken to determining a TSLRIC cost base price of each relevant service in the value chain.

Confidentiality

84. We believe the proposed approach is workable provided the bar for confidentiality is set high and not applied in a blanket way to information provided by parties. Chorus now operates

¹⁴ The LOI theory remains controversial - difficult for regulators to implement. Further, from a policy perspective, it makes little sense when a transition to fibre is occurring (see page 13 of Martin Cave report for Chorus <http://www.chorus.co.nz/file/19212/Chorus-Attachment-5---Martin-Cave-report.pdf>).

¹⁵ See RIS referred above.

solely at the wholesale level and, therefore, less information is likely to be confidential in the past when operating at wholesale and retail.

85. Chorus has suggested that, in circulating confidential material, the responsible lawyer may not need access to the confidential information itself [184].
86. In terms of managing the information, our experience has been that there is significant value in the internal co-ordinator being able to work with external consultation to identify and obtain information and data that can be obtained from within the firm (while not disclosing the confidential information). This is then used to test the reasonableness and approach taken by other parties. The ability to do this is more important where parties external advisors have do not have extensive ongoing access to internal data. Chorus is likely to have an advantage here in that, with its external advisors, it has been preparing detailed costs for some time and s98 notices suggest the Commission will, at least in first instance, rely on Chorus derived inputs. Conversely, the proposed approach would further impede other parties' ability to engage fully in the process.
87. Accordingly, in this case, we recommend that the Commission permit any nominated regulatory professional to manage the confidentiality process subject to undertakings (for example, that the person does not also have a strategy or commercial role and non-disclosure commitments). We believe these obligations should apply irrespective of whether the Commission decide to limit the role to nominated counsel.
88. Further, irrespective of the approach, the Commission should permit the nominated person to manage and co-ordinate confidential information.

END

Attachment: response to Chapman Tripp memorandum