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MEMORANDUM

To: Graham Walmsley, CallPlus Limited

From: Andrew Matthews & Gus Stewart

Date: 3 October 2014

Subject: **SUBMISSIONS ON THE CONSULTATION PAPER ON ISSUES RELATING TO CHORUS' PROPOSED CHANGES TO THE UBA SERVICE**

Summary of our views on the submissions

1. You have asked us to review and provide our views on the submissions made by parties on the Commission's consultation paper and attached legal opinion (**Commission's Opinion**).[1] In summary, on the information to hand we consider that:

   a. Spark's submissions[2] are broadly correct, and Wigley & Company's submission[3] appears to make some important points.

   b. Chorus' submissions[4] do not, in our view, appear to accurately define or address the fundamental questions. In particular, this is not a question of whether a statutory requirement to act in good faith imposes new "undefined" obligations. Nor do Chorus' submissions appear to properly analyse the relevant conduct. As such, the bulk of Chorus' submissions (approx. 55 pages) do not appear relevant.

2. In our view, the fundamental questions are:

   a. **Does Chorus have the right to unilaterally withdraw or artificially constrain the regulated service that it is providing?**

   b. **What is the effect of the good faith obligation in clause 2.2.1 of the STD General Terms?**

3. To answer those fundamental questions in turn:

   a. Even if one accepts Chorus' view that the STD is a "*comprehensive and self-contained*" code, having committed to provide the regulated service using VDSL technology under the terms of the STD, there is no provision enabling Chorus to then unilaterally withdraw or artificially constrain that service. Even if (as has been argued) an access provider provides more than a specified minimum, it cannot "read in" an ability to unilaterally

[1] Consultation paper on issues relating to Chorus' proposed changes to the UBA service, 4 September 2014.
[2] (1) Spark, Consultation paper on issues relating to Chorus' proposed changes to the UBA service, 18 September 2014 (**Spark's Submission**) and (2) Russell McVeagh, Submission on behalf of Spark, 18 September 2014 (**Russell McVeagh Opinion**) (together, **Spark's submissions**). For the purposes of this memo, we refer to all submissions made on behalf of Spark as being the views of Spark.
[3] Wigley & Company solicitors, Submission on Consultation Paper on issues relating to proposed UBA changes, 18 September 2014 (**Wigley Opinion**).
[4] (1) Chorus, letter from Mark Ratcliffe, Chorus Regulated UBA and Boost Proposals, 18 September 2014 (**Chorus Letter**), (2) Chorus, Submission in response to the Commerce Commission's Consultation Paper on issues relating to Chorus' proposed changes to the UBA service, 18 September 2014 (**Chorus' Submission**), (3) Chapman Tripp, Submission on behalf of Chorus, 18 September 2014 (**Chapman Tripp Opinion**), and (4) Minter Ellison Rudd Watts, Submission on behalf of Chorus, 18 September 2014 (**MERW Opinion**) (together, **Chorus' submissions**). For the purposes of this memo, we refer to all submissions made on behalf of Chorus as being the views of Chorus.

define the level at which it provides the regulated service. Accordingly, the arguments on *minimum* throughput do not appear overly relevant.[5]

b. Chorus acknowledges that the STD is a statutory instrument.[6] As outlined in our memo of 18 September,[7] the good faith obligations in this context are clear. They are to *"forbid opportunistic behaviour"* and ensure delivery with the *"justified expectations of the other party"*. They also "[offer] *a warning that game playing at the margins of a statutory… obligation may attract a finding of liability."* In the absence of an express ability to withdraw or artificially constrain the regulated service, or even if there is simple ambiguity, it seems clear that there must be very real doubts about whether this conduct could be regarded as being in "good faith".[8] This is particularly so in the context of a regulated service, when the regulated service provider appears to be aiming to force users to take up what it argues is a non-regulated service.[9]

4. There appear good grounds to argue that, if Chorus was truly carrying on its obligations[10] under the STD in good faith in these circumstances it would be expected to have waited until 1 December before announcing such a "two-pronged" proposal. Put another way, it is legitimate to ask whether a reasonable access provider, acting in good faith, would seek to do this if the three year regulatory "freezing" period had already expired.

5. Much has been made of the Commission's WVS decision.[11] That decision was made in quite different circumstances, and before the 2011 amendments to the Act. Significantly, it related to the introduction of a new service. (It is not clear to us whether or not that decision was correctly decided, but in any event the conclusions do not seem applicable.)

The way forward

6. It appears that there is a divergence of views on these issues.[12] We agree with Spark that without clear guidance from the Commission on how to address this matter, access seekers will continue to face uncertainty as to how it will be resolved.[13]

7. The Commission would clearly be justified in clarifying the STD under s 58 of the Telecommunications Act (**Act**) (at its own initiative) or s 156O(2)(b)(i) of the Act (following Spark's complaint of an alleged breach), if it thought that was necessary to remove any potential ambiguity.[14] The Commission may also be satisfied (having obtained an *independent* legal opinion on these issues) that enforcement action is appropriate. We note that the Act does not appear to require the Commission to find an *actual* breach before taking action under s 156O(2)(b).[15] A review under s 30R may also be appropriate on 1 December.

8. If Chorus persisted with its proposals, it would seem appropriate for the Commission to seek an interim injunction as there appears to be a serious question to be tried, and the balance of convenience would seem likely to favour the granting of such relief.

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[5] As noted, the issue is not about whether or not there is an obligation to provide new services, or to provide existing services using new technology, it is about an obligation to maintain continuity in relation to services already being provided.
[6] Chapman Tripp Opinion, para 18.
[7] Refer to our memo of 18 September for quote references.
[8] We note that "continuity of service" is surely part of a good faith obligation.
[9] We note that the Commission is yet to determine whether or not the Boost services fall outside the STD.
[10] Which include notifying the Commission if it intends to offer a new UBA variant – clause 10 of the STD General Terms.
[11] Commerce Commission, Final Decision of the Commerce Commission on the applicability of the UBA STD to Telecom's Wholesale VDSL2 Service, 20 December 2010.
[12] This point was also observed in the Russell McVeagh Opinion, para 6.
[13] Russell McVeagh Opinion, para 6.
[14] These actions do not appear to be precluded following the Court of Appeal's decision in relation to the UBA IPP (Chorus Limited v Commerce Commission *And Ors* (CA 229/2014) [2014] NZCA 440). We are not aware of Chorus having lodged an appeal against this decision.
[15] We agree with Wigley & Company that the ultimate decision maker is the court. The Commission only decides what to do about the complaint, such as whether to issue proceedings against Chorus. See Wigley Opinion, para 1.8(a).

9. Finally, we note that the relevant conduct may also give rise to "estoppel" arguments (ie if there has been reasonable reliance by access seekers on statements made by Chorus) and / or Fair Trading Act claims. While we have not considered these issues further in this memo it would seem appropriate for the Commission to do so.

10. Below we discuss Chorus' conduct in the context of the relevant regulatory regime, and comment on some of the arguments put forward by Chorus.

Chorus' conduct must be considered in the context of the relevant regulatory regime

11. Chorus' submissions appear to ignore the context within which the proposal is being made. Rather than analysing each aspect of the proposal in isolation, the question that should really be asked is: "what is going on here"?[16]

12. While the Commission's Opinion reached a clear conclusion on this, it is worth briefly restating the relevant conduct:

    a. Chorus is a regulated monopolist, offering the regulated UBA service pursuant to the STD.

    b. Chorus is proposing to withdraw or artificially constrain that service (or parts of it) – that will fundamentally change the service that is being offered, and potentially have different impacts on different access seekers. At the *same time*, it is proposing to introduce its new Boost services which it assumes (and is asserting) are "commercial variants" ie not subject to regulation.

    c. The concurrent timing of the changes to the regulated service and introduction of Boost suggests that Chorus may be attempting to encourage migration from a regulated (ie price and non-price protected) service to a non-regulated service.

    d. That proposal has been made shortly before the end of the 3 year regulatory "freezing" period.

13. That conduct should be considered in the context of the wider regulatory regime, the purpose of which is to ensure that access seekers can obtain access to the regulated service on sufficiently defined price and non-price terms, without needing to enter into any additional terms with the access provider.[17] The regime is fundamentally designed to ensure that the regulated service is, and remains, available to access seekers and meets the purposes set out in s 18 of the Act. This is relevant to the rationale for the conduct, and whether or not that conduct is in good faith (and otherwise consistent with the STD).

14. We agree that there is a role for contractual certainty, although arguably the need for contractual certainty is just as great, if not greater for access seekers. In particular, access seekers should have certainty of the supplied service. In any event, this is clearly a regulated access regime, not a contractual document negotiated between commercial parties.[18]

15. Services that meet or exceed the defined service description in the STD are *prima facie* regulated services. If the access provider introduces a new service which it purports falls outside that defined service description, it must comply with the notification process in clause 10 of the STD General Terms so that the Commission has adequate time to consider whether those services do in fact fall within the service description in the STD (ie the new service is not

[16] To quote Maureen Brunt, Economic Essays on Australian & New Zealand Competition Law, published by Kluwer Law International, 2003, page 354.
[17] Section 30O(1)(a) of the Act.
[18] This point was also observed in the Russell McVeagh Opinion, para 10.

sufficiently differentiated from the regulated service), or whether the STD should be amended to make it clear that the new service was intended to fall within the STD.

16. Most parties appear to have accepted that there may be mutual benefits from this process by allowing commercial variants over and above the regulated service, provided there is *actual* demand for those services. However, nothing in what we have read anticipates that those commercial variants would be reviewed in the context of artificially constraining (or withdrawing) what is provided as the regulated service. (As a separate point, the current situation perhaps highlights the risks flowing from an attempt by access seekers to allow a "pragmatic" approach towards the regulated service. The intent was surely that any such commercial offerings went over and above what was already provided. This presupposes good faith.) In other words, at the very least there seems to be an assumption of "ceteris paribus".

17. We agree with the submissions of Spark that the regulatory framework does not permit Chorus to engage in conduct that would *"have a negative impact on competition in downstream telecommunications markets that rely on the UBA service*"[19] or that would "*not be left unchecked in a competitive market, as this would be inconsistent with section 18.*"[20]

18. We also agree that this (or similar) conduct is the type of behaviour that regulation under Part 2 of the Act, guided by the section 18 purpose, should seek to prevent.[21]

Comments on Chorus' suggested approach and arguments

19. In this section we comment on some of the main arguments put forward by Chorus, and explain the ramifications of accepting those arguments.[22]

20. Chorus argues (or at least appears to assume) that:

    a. The (artificially constrained) service it intends to provide will "*not only meet, but exceed*"[23] the relevant performance specifications under the STD. In particular, its sole obligations in relation to throughput are to meet or exceed the specified minimum.[24]

    b. The STD provides a process for introducing new UBA variants, and that the Commission's WVS decision confirms that, so long as that proposed variant has "enhancements" over and above the defined service description, it can be offered outside the STD on commercial terms.[25]

    c. Effectively there is no good faith obligation, or if there is it is only an aid and can mean "*no more than honest cooperation in relation to the defined "UBA Service*"".[26]

    d. The STD cannot, through good faith obligations (or other obligations such as duties to comply with the principles set out in the Act, including international best practice), impose undefined obligations.[27]

[19] Russell McVeagh Opinion, para 24(b).
[20] Russell McVeagh Opinion, para 24(a).
[21] Russell McVeagh Opinion, para 14.
[22] For the purposes of this memo we have focussed on what appear to be the key arguments raised in Chorus' submissions. We have not addressed every incorrect or inconsistent statement made in Chorus' submissions.
[23] MERW Opinion, para 1.9(f).
[24] MERW Opinion, para 1.9(e).
[25] Chorus' Submission, para 48.
[26] Chapman Tripp Opinion, para 5.5.
[27] Chapman Tripp Opinion, para 22.

e. The STD is a "*comprehensive and self-contained*" code, because the Act requires that it be a complete contract and it is "*remarkably detailed – over 250 pages of text*".[28]

21. Taking each of these arguments in turn:

Arguments about the "minimum" are not overly relevant

22. As noted, we consider that arguments about whether or not the regulated service being provided meets or exceeds the "minimum" requirements are not overly relevant to the real issue of whether or not Chorus is permitted to unilaterally withdraw or artificially constrain the regulated service. We agree that *"*[t]*here is no express provision in the STD that gives Chorus the ability to actively manage throughput*."[29]

23. However, even if those arguments were relevant, we agree that:

a. Chorus' view that its only (relevant) obligation under the STD is to provide a minimum throughput of 32 kbps "*cannot be a correct interpretation of this aspect of the UBA STD. On that basis, it would be open to Chorus to unilaterally determine what service level it chooses to provide from time to time, above the 32 kbps "floor*"."[30]

b. Arguing that the "*minimum level is all* [the access provider] *is required to provide going forward* […] *ignores the fact that the STD is an instrument of regulation*" and that the STD is "*not, for example, a contractual document negotiated between commercial parties*".[31]

24. We also agree with Spark's submissions that it was not contemplated that "*when the actual service levels (comfortably) exceed the floor or new technology was introduced, the service provider* [could] *move backwards or take steps to halt progress to degrade the performance of the service, at any time and to any level of its choosing*" or that "*the monopoly service provider would be allowed to effectively dictate the level of regulated service it wished to provide*."[32]

The conclusions in the WVS decision are not necessarily applicable to the current proposal

25. We acknowledge that parties have accepted (and even encouraged) a process whereby new commercial variants could be introduced without automatically being subject to the regulated terms (subject to there being demand for those variants, and Chorus complying with the notification process).

26. However, the facts and circumstances of the WVS decision appear clearly distinguishable from the current proposal. We understand that that decision pre-dated the 2011 amendments to the Act, at a time when Telecom was vertically integrated (ie there was clearly access seeker demand for a VDSL service), and that the issue was solely about the introduction of a *new* and unproven service (ie there was no proposal to also change the way the regulated service was provided). We agree with Spark that "[when] *the Commission permitted WVS to be a commercial service, it did so only on the basis that the regulated service would not be withdrawn or degraded and would continue to be provided under the STD terms.*"[33] We do not consider that the conclusions in the WVS decision are applicable to the current proposal.

[28] Chapman Tripp Opinion, paras 22-23.
[29] Russell McVeagh Opinion, para 29.
[30] Russell McVeagh Opinion, paras 30(a)-(b).
[31] Russell McVeagh Opinion, paras 9-10.
[32] Russell McVeagh Opinion, paras 16-17.
[33] Spark Submission, para 21.

There is an explicit (statutory) good faith obligation in the STD General Terms

27. As noted, there is an explicit good faith obligation in clause 2.2.1 of the STD General Terms. Further, as submitted by Spark, the starting point must be that the good faith requirement was "*deliberately included in the STD and should be given a meaningful effect*."[34]

28. We discussed the case law regarding "good faith" obligations in a statutory context in our 18 September memo. For present purposes we note:

    a. Chorus' submissions do not appear to address the relevant cases, instead focussing on cases dealing with the question whether of or not there is an *implied* obligation of good faith.

    b. As our 18 September memo clearly noted, there is an express statutory obligation of good faith in the STD General terms. In a regulatory context in particular, a good faith obligation "*offers a warning*" to not attempt to frustrate the purpose of the relevant provisions or legislation. (Although the distinction may be a fine one as those same obligations have been accepted in at least two recent leading English cases dealing with contractual obligations of good faith.)

    c. Chorus have accepted that the STD is a statutory instrument. We cannot then see how they can seek to avoid a clear statutory obligation in that statutory instrument.

    d. Chorus' submissions do not appear to address whether or not Chorus was, taking all relevant factors into account, acting in good faith. In other words, the submissions do not address whether it is "bad faith" to withdraw or artificially constrain a regulated service, or whether the act of doing so in order to avoid or bypass regulation would amount to "bad faith". Instead, Chorus' submissions seem to suggest that, so long as the (other) specific terms are met, there can be no lack of good faith. (Chorus' submissions even appear to suggest that by simply acting in the interests of its shareholders it is "*not engaged in any "ulterior motive*"".)[35]

    e. That approach appears directly inconsistent with the case law dealing with good faith obligations in a statutory context and with the apparent intent here.[36]

29. We agree with Spark's submissions that:

    a. "[…] *it is difficult to see how a monopoly service provider which is taking steps that will reduce the quality of a regulated service and affect the downstream services that can be offered, while at the same time improving the attractiveness of a parallel commercial (non-regulated) offering, could be said to be acting in good faith and in furtherance of the section 18 purpose statement*."[37]

    b. "[i]*n the context of the STD, the "good faith" obligation requires Chorus to carry out its obligations in a way that is faithful to the section 18 purpose, recognises the justified expectations of access seekers, and does not frustrate the intent of the STD and the Act*."[38]

[34] Russell McVeagh Opinion, para 19.
[35] Chapman Tripp, para C.10.
[36] Although it is worth repeating that these comments were cited in the context of contractual obligations of good faith with approval.
[37] Russell McVeagh Opinion, para 18.
[38] Russell McVeagh Opinion, para 5(c).

The good faith requirement in the STD does not impose additional, undefined obligations

30. The requirement to act in good faith, as set out in clause 2.2.1 of the STD General Terms, is explicit and unambiguous. We agree with Spark's submissions that "[…] *this is not a case of a requirement to act in good faith introducing additional obligations on Chorus. Rather, it would amount to recognition that the UBA STD, properly interpreted, does not permit Chorus' proposed changes to the regulated service*."[39]

31. The length of Chorus' submissions on this point do not alter this view. Rather, that approach seems to be a case of "protesting too much". This obligation seems quite clear.

The STD is a "comprehensive and self-contained" code

32. This interpretation of the STD is inconsistent with the fact that the Act sets out a number of processes whereby an STD can be clarified or amended – thereby acknowledging that there may be some "gaps" or changes required to be made to the regulated terms.[40] This interpretation is also inconsistent with the fact that s 30O(1)(a) only requires an STD to specify "*sufficient*" terms to allow the regulated service to be made available without the need for the access seekers to enter into an agreement with the access provider.

33. We agree that "*to the extent there is any residual uncertainty created by a "living" document such as the STD, that is the very purpose of the Commission's power of clarification*."[41]

34. We also note that there is an internal inconsistency in the numerous arguments advanced by Chorus (in various guises) arguing that the STD is "complete" on the one hand, and then seeking to refer to a number of documents and communications outside the STD as an aid to interpretation.

Limitations

35. The limitations noted in our advice of 18 September apply, with any necessary modifications.

Yours faithfully
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[39] Russell McVeagh Opinion, para 26.
[40] We note, for example, the s 30R (review), s 58 (clarification), s 59 (clarification), s 30ZB (residual terms determination) and the s 156O(2)(b)(i) clarification processes.
[41] Russell McVeagh Opinion, para 27.