

Process and issues update paper for UCLL and UBA pricing review determinations

Consultation paper

Date: 19 December 2014

Introduction

1. On 2 December 2014 we published our draft pricing review determinations for the UCLL and UBA services. At that time we also indicated we would issue a process update shortly.
2. Since then we have received a number of requests from Chorus, CallPlus, Spark, Vodafone, Wigley & Company, InternetNZ, Consumer and TUANZ seeking an extension to our current consultation timeframe.
3. We have also received a letter from CallPlus raising concerns about the uncertainty of any backdating of the final FPP prices.¹ Spark has also publicly expressed concern about backdating.²
4. The purpose of this paper is to:
 - 4.1 provide an update on the process, including responding to extension requests; and
 - 4.2 share our emerging views on backdating and seek submissions.

Process update

5. We have decided to grant an extension of one month for submissions on the UCLL and UBA draft determinations, to allow interested parties to make considered submissions. We have been persuaded to grant additional time for making submissions in this case for the following reasons:
 - 5.1 We are consulting on a wide range of issues, many of which are complex.
 - 5.2 In particular, we have published two draft determinations. While many issues are common, there are also many issues unique to each.
 - 5.3 This is the first opportunity parties have had to consider a range of new material, in particular our draft model and the associated model documentation from TERA.
6. This makes the revised submission due dates as follows:
 - 6.1 Submissions are now due by 5pm on Friday 20 February 2015; and
 - 6.2 Cross-submissions are now due by 5pm on Friday 20 March 2015.

¹ Callplus, "Indication of Commission's thinking with respect to backdating", a letter to Commissioner Stephen Gale, 15 December 2014.

² See, for example, USB, "Spark New Zealand Ltd signals copper price increases from February", 10 December 2014 at https://neo.ubs.com/res/ubs/3de902a42014f5eed53407dcc8f61c2a.pdf?o_id=6821691

7. Submissions and cross submissions on the cost of capital draft decision are also due on those dates, as are submissions on the preliminary view on backdating set out later in this paper.
8. We have not extended the deadline for submissions on the consultation paper on a possible section 30R review of the UBA STD General Terms and Service Description: it remains by 5pm on 23 January 2015.
9. To help with the submission process, we will provide technical assistance to parties regarding the model throughout the consultation period. During this period we will be answering questions relating to the model inputs and calculations on a weekly basis. The questions, answers and the party's names will be published on the Commerce Commission website. Queries should be sent to telco@comcom.govt.nz and include 'Draft FPP model query' in the subject line. We do ask that parties first read the supporting documentation provided by TERA before approaching us for assistance.
10. Extending the consultation period affects our process. As a result, the conference, which was previously scheduled for March 2015, will now be held mid-April 2015 and will primarily focus on monthly charges. Following the conference, we intend to publish a further draft determination incorporating any revisions to our draft decisions on monthly charges, taking into account submissions, as well as setting out our draft decisions on non-recurring charges and backdating. As there will be less new material³ for parties to consider in the further draft determinations than in the draft determinations under current consultation, and having regard to the extended consultation timeframes and conference being provided on the current draft decisions, parties should expect shorter periods for submissions on the further draft determination.

³ By 'new material', we mean that there will be fewer topics or issues on which we have never previously expressed a view or provided draft reasons. As we receive and consider submissions, it remains the case that we may form and publish different draft decisions and/or reasons on topics and issues on which we have previously published a draft decision.

11. Our intended process for the remaining stages of the pricing review determinations process is as follows:

Step	Date (2015)
Due date for submissions on the UCLL and UBA draft determinations (including cost of capital draft decision and the preliminary view on backdating in this paper)	20 February
Due date for cross-submissions on the UCLL and UBA draft determinations (including cost of capital draft decision and the preliminary view on backdating in this paper)	20 March
Conference on monthly charges (two days)	15-16 April (indicative)
Further UCLL and UBA draft determinations published, incorporating any revisions to our draft decisions on monthly charges as well as setting out our draft decisions on non-recurring charges and backdating	29 May (indicative)
Due date for submissions on the further UCLL and UBA draft determinations	19 June (indicative)
Due date for cross-submissions on the further UCLL and UBA draft determinations	7 July (indicative)
Final UCLL and UBA pricing review determinations published	September (indicative)

Emerging view on backdating

12. This section sets out our preliminary view on whether or not to backdate the regulated prices for the monthly charges for the UBA, UCLL, SLU and UCLF services.
13. Our preliminary view is that the final FPP monthly prices that we determine for these services will be backdated to 1 December 2014, but not earlier than 1 December 2014. We explain the reasons for this preliminary view further below and we invite submissions.

Our preliminary view

14. We remain of the view that that we are not required to backdate our pricing review determinations, but we have discretion to do so.⁴ This has been based on our legal advice from Dr James Every-Palmer and submissions we received on this issue.

⁴ Commerce Commission, "Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services" 9 July 2014, paragraph [298].

15. In forming our preliminary view to backdate prices to 1 December 2014, we considered the following criteria specified in our draft determination and in our July 2014 regulatory framework and modelling approach:⁵
- 15.1 The section 18 purpose statement will provide us with the most important guidance.
 - 15.2 In particular, any decision to backdate will need to be demonstrably efficient.
 - 15.3 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.
16. A key reason in favour of backdating a final FPP price is that the FPP price can be seen as a correction of the 'proxy' IPP price, the FPP price being a more accurate implementation of forward-looking cost-based pricing. The Court of Appeal has stated that:⁶
- "...the IPP is to be a preliminary estimate, based on benchmarking, of the price that may, if necessary, ultimately be determined for the FPP. In other words, the IPP is intended as "a proxy" for the FPP."*
17. Against this, 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.
18. Overall, we recognise that the issue of backdating must be assessed on a case-by-case basis and in the light of the application of section 18 to particular circumstances. Accordingly, our preliminary view in favour of backdating in this case should not be seen as an indication of any general policy regarding backdating.

⁵ Commerce Commission, "Draft pricing review determination of Chorus' unbundled copper local loop access service" 2 December 2014, paragraph [42]-[44].

⁶ *Chorus v Commerce Commission* [2014] NZCA 440 at [34].

UBA

19. Our 2 December 2014 UBA draft determination noted the following potential options for backdating of UBA prices:⁷
- 19.1 Backdating the final UBA price to take effect from the date of the draft determination (2 December 2014). We noted that final UBA price could only be backdated to take effect from 1 December 2014, but no earlier.⁸
- 19.2 Not backdating any final prices, so that they come into effect on the date of the final determination.
20. The price for UBA that was set under the previous 'retail-minus' pricing principle was frozen in place from three years from the day Chorus separated from Telecom (now Spark), meaning the new cost-based prices (either IPP prices or FPP prices) could only take effect from 1 December 2014.⁹ This means it is open to us to backdate the final FPP price for UBA to take effect from 1 December 2014, but no earlier.
21. The Act required us to make reasonable efforts to complete the pricing review determination before the expiry of three years from separation day, which was 1 December 2014.¹⁰ Despite our efforts, we have not yet completed the pricing review determination, but were able to release draft prices for the monthly charges on 2 December 2014.
22. 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. If there is a delay in implementing the final FPP prices (whether due to a change in the process or subsequent litigation which protracts any finality of the pricing), investors may be deterred from innovating and investing in a way that would grow the overall market and promote competition. Investment can promote competition for the long-term benefit of end-users, and accordingly avoiding disincentives to investment incentives can promote competition and give effect to the section 18 purpose statement.

⁷ Commerce Commission, "Draft pricing review determination of Chorus' unbundled bitstream access service" 2 December 2014, paragraph [41]-[43]; also see Commerce Commission, "Consultation paper outlining our proposed view on regulatory framework and modelling approach for UBA and UCLL services" 9 July 2014, paragraph [299].

⁸ Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011, section 77(2). The price for UBA that was set under the previous 'retail-minus' pricing principle was frozen in place from three years from the day Chorus separated from Telecom (now Spark). The new prices for UBA (either IPP prices or FPP prices) cannot take effect earlier than 1 December 2014.

⁹ Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011, s 77(2).

¹⁰ Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011, s 78(3).

23. Overall we consider that section 18 would be better served by having the most accurate price (ie, the FPP price and not the IPP price) take effect from the first day after the 'retail-minus' price freeze ends. Our preliminary view is to backdate the final FPP monthly price for the UBA service to 1 December 2014.

UCLL, SLU and UCLF service

24. Our 2 December 2014 UCLL draft determination noted the following potential options for backdating of UCLL, SLU and UCLF prices:¹¹
- 24.1 The final prices could be backdated to take effect from the date of the draft determination (2 December 2014) or, in the case of non-recurring charges, the date of our supplementary draft determination.¹²
- 24.2 The final prices for UCLL, SLU and UCLF could be backdated to take effect earlier, potentially back to the date of the IPP re-benchmarking decision (3 December 2012).
- 24.3 Not backdating any final prices, so that they come into effect on the date of the final determination.
25. The application for a pricing review determination of the UCLL and SLU services was on the 2012 re-benchmarking decision, and not the initial 2007 UCLL benchmarking decision. Accordingly, the earliest date from which the FPP price could take effect is 3 December 2012, ie, the date of the re-benchmarking decision.
26. We also note that the UCLL and SLU national geographic price takes effect on 1 December 2014, the same date the UBA 'retail-minus' price freeze ends.
27. In reaching a preliminary view on the period of backdating we have considered the trade-off between the benefits and costs of backdating, and which of the three options would best give effect to the section 18 purpose statement.
28. We consider that it is possibly damaging to investment incentives if parties are disadvantaged by the time taken to complete the FPP, as discussed at paragraph 22 above. That is a consideration in favour of backdating, at least to 1 December 2014, which is when Parliament envisaged the UBA FPP pricing process might be completed.

¹¹ Commerce Commission, "Draft pricing review determination of Chorus' unbundled copper local loop access service" 2 December 2014, paragraph [42]-[44].

¹² The final UBA prices could be backdated to take effect from 1 December 2014, but no earlier. Section 77(2) of the Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011, s 77(2) provides for the price for UBA that was set under the previous 'retail-minus' pricing principle to be frozen in place from three years from the day Chorus separated from Telecom (now Spark). The new prices for UBA (either IPP prices or FPP prices) cannot take effect earlier than 1 December 2014.

29. We have considered the interplay between UBA and UCLL price review determinations to inform a decision on backdating:
- 29.1 In particular, we note that the Act provided for a freeze on UBA prices to 1 December 2014, along with prohibiting Spark from unbundling, to protect retail service providers' recovery of their investment in unbundling.¹³
- 29.2 We consider that retrospectively applying a different price to UCLL for the two year period from the UCLL IPP to 1 December 2014 will conflict with the intention of that freeze as regards unbundlers.
- 29.3 Retrospectively adjusting only the UCLL price would have the effect of changing the relativity between UCLL and UBA services during that period and would have a negative effect on unbundlers.
30. Backdating the UCLL prices to the same date as for UBA prices also provides the best outcome for the relativity of the UBA and UCLL services. The Act requires us to consider relativity in the application of section 18.¹⁴
31. One potential concern in the case where backdating would favour Chorus, is that, if the amounts involved are substantial enough, they could cause a firm to exit the market, which would likely be detrimental to competition. Given that we cannot accurately forecast the likelihood of firms exiting, this introduces uncertainty on the impact. We note that the larger the sums of money; and the longer the backdating period, the greater the likely impact.
32. We intend to forecast the impact of potential backdating on retail service providers, and consider this when making our final decision on backdating and whether there are mechanisms that could mitigate those impacts.
33. On balance our preliminary view is that we would be likely to best give effect to the section 18 purpose statement by backdating the final FPP prices for UCLL, SLU, and UCLF to 1 December 2014, but not earlier.

Consideration of practical implementation of backdating

34. We invite submissions on how, if we were to decide to backdate the final FPP prices, as per the preliminary views expressed in this paper, we should factor the transfers of money into the prices of the UBA, UCLL, SLU, and the UCLF services in order to allow for the repayment to Chorus over time, or, if the final FPP prices were lower than the IPP prices, the reimbursement by Chorus over time.
35. Submissions should also provide a view on the practical options to implement backdating.

¹³ This also provided Chorus with an income stream based on the higher 'retail minus' price.

¹⁴ Telecommunications Act 2001, s 19(b).