

**VODAFONE NEW ZEALAND LIMITED**  
**SUBMISSION TO THE NEW ZEALAND COMMERCE COMMISSION**



**COMMENTS ON FURTHER CONSULTATION PAPERS ON ISSUES  
RELATING TO DETERMINING A PRICE FOR CHORUS' UCLL AND  
UBA SERVICES UNDER THE FINAL PRICING PRINCIPLE**

**Public version**

**11 April 2014**

## **A Introduction**

- A1 Vodafone New Zealand Limited (**Vodafone**) welcomes the opportunity to comment on the Commerce Commission's (**Commission**) further consultation papers on issues relating to determining a price for Chorus' UCLL and UBA services under the final pricing principle (the **Further Consultation Paper** and the **Backdating Paper**).
- A2 This submission also addresses a number of concerns which have arisen following the presentation delivered by the Commission's expert consultants to interested parties, on the proposed approach to modelling, earlier this week.
- A3 We note that the specific questions raised in the Further Consultation Paper and the Backdating Paper are relatively narrow, but our participation in the preceding workshops has indicated that there are wider decisions which will be taken by the Commission prior to the commencement of modelling. Accordingly, we have set out our views on these assumptions as much as possible in the time allowed.

## **B Recommendations**

- B1 Vodafone recommends that the Commission should:
- (a) favour a single fibre and fixed wireless access MEA, common between UCLL and UBA;
  - (b) consider whether it is appropriate to model alternative MEA candidates (such as a copper-based MEA) in parallel;
  - (c) issue a consultation document before the draft determination setting out the key assumptions (and the reasons underlying them) which it intends to provide to its expert consultant before the model is built;
  - (d) treat relativity between the UCLL and UBA services as a mandatory consideration, but recognise that the TSLRIC prices for each of these services is likely to reflect the price which best gives effect to s 18;
  - (e) develop, and consult on, a framework for exercising its discretion in relation to backdating in this instance;
  - (f) ensure a constructive approach to confidentiality that avoids restricting information to external counsel and experts only;
  - (g) consider whether further consultation steps should be undertaken (including before and after the commencement of the modelling exercise) prior to the release of its draft determination in August.
- B2 Finally, Vodafone has also set out a number of smaller comments in relation to some of the emerging modelling assumptions discussed at the industry workshop earlier this week.

## C Selecting the Modern Equivalent Asset (MEA)

C1 In our view:

- (a) the most appropriate MEA is likely be a FTTH and fixed wireless access (**FWA**) network;
- (b) the Commission should favour a single MEA shared between UCLL and UBA;
- (c) the Commission should consider whether it should model multiple MEAs (as was the approach adopted in Denmark) to ensure that an appropriate TSLRIC price can be determined;
- (d) the Commission has not expressed a clear approach (or preference) for the selection of the MEA, making it difficult for parties to definitively comment on the decision that we expect the Commission will be required to undertake ahead of the commencement of modelling;<sup>1</sup> and
- (e) the MEA selection is a fundamental lever in TSLRIC cost modelling. The current timeline may result in a MEA selection choice that is effectively irrevocable at the point of the draft determination.

### **The correct MEA is most likely to be fibre and FWA**

C2 As set out above, it is difficult to conclusively identify the most appropriate MEA without undertaking some level of cost modelling analysis. That said, absent such analysis, we agree that observations such as that of the Minister of Communications and Information Technology that “[n]o-one would build a new copper network today; they would deploy a modern fibre network”, are likely to hold true.<sup>2</sup>

C3 This view is supported in the analysis of Professor Martin Cave, in his report prepared for Chorus:

*[Forward looking prices] are usually based upon the proposition that existing assets will be (or would be) replaced by similar assets (that is, a copper-based loop). But that necessary foundation for TSLRIC access pricing does not hold in light of the contractual implementation of fibre roll-out in New Zealand. It is likely that suppliers and customers in the market place have adjusted their expectations to take account of fibre as the technology of the future. If this is the case, then the whole justification for pricing UCLL at the TSLRIC of a copper-based loop is undermined.<sup>3</sup>*

C4 Professor Cave also suggests that dynamic efficiency benefits associated with fibre, including positive externalities, are more likely to accrue via new services as opposed to current generation copper services.<sup>4</sup> As such, we consider that a fibre-based MEA is likely to provide the correct route for the Commission to discovering TSLRIC pricing for both the UCLL and UBA services in urban areas.

C5 However, we consider that a FWA component, used for coverage in sparsely populated areas, should also be incorporated in the MEA. While this was not a feature of the modelling update

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<sup>1</sup> See discussion below at [C19] – [C25].

<sup>2</sup> Hon Amy Adams *Launch of the Telecommunications Act discussion document* (speech, 7 August 2013).

<sup>3</sup> Professor Martin Cave *Regulating the price of copper in New Zealand: A report for Chorus* (13 June 2012), page 12

<sup>4</sup> *ibid* at page 13.

presentation delivered by the Commission's consultants earlier this week, we understand that TERA are able to include, and have previously modelled, a FWA component in their model.

- C6 On that basis, we submit that a FWA component is appropriate as a component of both the UCLL and UBA MEA because:
- (a) there is significant evidence of LTE-based services offering copper substitution services in international markets such as North America (Verizon), Sweden (TeliaSonera; Tele2) and Germany (Vodafone Germany);
  - (b) it reflects the most efficient technology for deploying broadband access to sparsely populated areas (for example, the expected CAPEX requirement per end-user for wireline technologies increasing significantly as density decreases; while the ability of wireless technologies to deliver higher speeds per end-user increases as density decreases);
  - (c) the availability of Digital Dividend spectrum in New Zealand, which delivers significantly improved propagation qualities, with performance further cementing the ability of wireless solutions to efficiently service quality broadband services to rural users.
- C7 There are a number of potential approaches to determining which customers are best served by wired or wireless technology (i.e., certain geotypes could be determined, as was the approach taken by the Swedish regulator). Vodafone can assist the Commission and TERA by assessing what proportion of rural customers served by Chorus' copper network could efficiently be served by existing and future mobile technology (including the RBI footprint, to the extent it overlaps with Chorus customers).
- C8 Finally, even if a copper-based MEA is preferred, we note that the Commission should still consider whether a wireless solution may still be appropriate for rural customers.

#### **Why a single, shared MEA should be preferred**

- C9 Our understanding is that the Commission intends to use a single, common MEA in determining both UBA and UCLL prices. However, the UBA process and issues paper can be read as suggesting that the Commission might adopt two different MEAs when determining the TSLRIC for the UBA service and the UCLL service.<sup>5</sup>
- C10 The advice of James Every-Palmer included with the Further Consultation Paper (the **12 March Advice**) identifies problems associated with using two different MEAs, specifically that:
- ...using different MEAs in respect of different service may create problems in terms of the allocation of common costs since the different services will be based on different network assumptions (see below). Conversely, however, using the current copper network as part of the MEA for both UCLL and UBA may not allow sufficient optimisation to generate an efficient forward-looking price for UCLL in terms of s 18...<sup>6</sup>*
- C11 In addition to these practical problems, using two different MEAs create significant risks to resulting final determinations of UBA and UCLL prices.

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<sup>5</sup> Commerce Commission *UBA Issues Paper* (7 February 2014) at [17].

<sup>6</sup> James Every-Palmer *FPP determination: Issues re service description and the modern equivalent asset* (advice to the Commerce Commission, 12 March 2014) (the **12 March Advice**) at [29].

- C12 The Telecommunications Act 2001 (**the Act**) offers no guidance as to selection of the MEA, and does not preclude the Commission using different MEAs when applying the FPPs for each of the services. But the Commission is not unconstrained when making these choices.
- C13 The appropriate MEA to be used when determining the TSLRICs of the relevant services is a question of fact. This question must be answered by reference to facts and evidence, and inferences arising from those facts, albeit in circumstances where judgment is being made as to the hypothetical network asset that constitutes the most appropriate MEA. The Commission's approach to identifying the MEA to be used in determining TSLRICs for both services must be analytically consistent. The Commission must ask itself a common set of questions about how the appropriate MEA should be identified. It cannot ask a wider or narrower set of questions depending on the particular service in question (or, at least, differences between the services do not in any obvious way support the Commission asking different questions). Each of the criteria for MEA selection that the Commission has identified requires it to answer questions in absolute terms, not relative terms, based on the particular service delivered via the MEA.<sup>7</sup>
- C14 In addition, the Commission cannot use different MEAs where doing so would result in inconsistent logic and analysis as between its final determinations for each service. To the extent that inconsistent logic and analysis does result as between determinations, this would in principle expose any determination based on this logic to risk. At the very least, an MEA selected for the purpose of determining TSLRIC for any one service would be a highly relevant consideration that must be taken into account when selecting MEA used to determine TSLRIC of the other service. Contemporaneously drawing different conclusions in relation to MEA from the same evidence within a close proximity of time would be illogical (it is difficult to envisage any circumstances in which evidence would support this).

### **Modelling multiple MEAs**

- C15 The Danish Business Authority (**DBA**) LRAIC model for fixed networks, developed by TERA, defines the MEA as “[t]he asset that can produce the stream of services produced by the existing asset at lowest cost.”<sup>8</sup> Further, the DBA paper notes that: “this suggests that on top of the analysis of whether the asset produces the same type of services as the existing asset at lowest cost, it is also necessary to look at operating costs and other performance characteristics in order to determine what the MEA is.”<sup>9</sup>
- C16 TERA has previously modelled multiple MEAs in Denmark – an approach we believe warrants serious consideration in New Zealand. Should the Commission conclude that there are multiple network architectures consistent with the definition of an MEA, then the relevant MEA, on efficiency grounds, should be that MEA capable of delivering the relevant services at least cost.
- C17 From the recent workshop, we understand the next round of consultation that is likely to occur will be the draft determination after the model has been built. Absent further consultation on the MEA that bringing together other key aspects of the modelling approach including the level of

<sup>7</sup> Commerce Commission *UCLL Process and Issues Paper* (6 December 2013) at [101] - [102]. See also Commerce Commission *Key Modelling Concepts – MEA & Demand* (presentation, 19 December 2013) at page 6.

<sup>8</sup> Danish Business Authority *Modification and development of the LRAIC model for fixed networks 2012-2014 in Denmark MEA ASSESSMENT* (May 2013) at page 6.

<sup>9</sup> *ibid.*

network optimisation (e.g., scorched earth/scorched node), the approach to use of existing infrastructure (e.g., use of ducts and the approach to depreciation) and other key assumptions, there is a real risk that any change to the MEA once the draft determination is reached would be extremely difficult and, practically, irreversible.<sup>10</sup>

- C18 For this reason, Vodafone recommends that the Commission give serious consideration to modelling multiple MEAs to ensure that the modelling will establish the efficient price for copper services.

### **The Commission has not expressed a clear approach for selecting the MEA**

- C19 The Commission's approach to selection of the MEA is set out in documents issued in both the UBA and UCLL FPP processes. We understand that the Commission considers these documents, when read together, provide a clear statement of its approach to MEA selection. Unfortunately, we disagree.
- C20 In the UCLL process and issues paper, the Commission sets out a number of factors that will influence or inform its selection of an MEA.<sup>11</sup> However, given that the Commission has expressly sought parties' views on whether additional factors beyond those set out should be considered, and on how these factors should be ranked, this paper does not purport to provide a definitive statement of how the Commission will approach MEA selection.
- C21 In addition, we note the Commission's view that "[i]t is likely that the various MEA options will fit some selection criteria better than others. Some level of judgement may be required to establish which options are suitable MEA candidates."<sup>12</sup> The Commission has, as yet, provided no information as to the criteria that it will apply when choosing between potential MEA candidates.
- C22 Potential MEA candidates ("*[t]he candidate MEA options...*") are identified in the UCLL process and issues paper, although it has been suggested that this may not be an exhaustive list of candidates.
- C23 The Commission's UBA process and issues paper has subsequently indicated that MEA selection would be constrained as follows: "...our current thinking is that the UBA MEA will utilise Chorus' copper based inputs potentially with rural broadband initiative (RBI) fixed wireless in place of copper in some rural areas."<sup>13</sup> If the Commission intends to adopt a single, shared MEA in determining both UBA and UCLL prices, then the effect of this statement is to eliminate a number of potential MEA candidates identified in the UCLL process and issues paper.
- C24 However, we note that preliminary legal advice provided to the Commission following the publication of its UBA process and issues paper concludes that the Commission is not required to mechanically adopt a service description or MEA that replicates all of the specific features of Chorus' present copper network.<sup>14</sup> That said, as this advice expressly does not represent a

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<sup>10</sup> See further discussion below in section H.

<sup>11</sup> Commerce Commission *UCLL Process and Issues Paper* (6 December 2013) at [101] *et seq.*

<sup>12</sup> Commerce Commission *UCLL Process and Issues Paper* (6 December 2013) at [103]. We understand that the Commission intends to adopt a single, common MEA in determining both UBA and UCLL prices, and we agree that there are good reasons for this approach. We consider that selection of different MEAs would lead to a number of issues, as set out in paragraphs [C9] – [C14] above.

<sup>13</sup> Commerce Commission UBA Issues Paper (7 February 2014) at [17]. The reason for this view given at [16] is that "...in considering the relevant MEA for UBA on its own, a hypothetical new entrant seeking to compete with Chorus' UBA service would utilise the existing layer 1 inputs that are currently available. This results in a practical constraint on the UBA MEA."

<sup>14</sup> James Every-Palmer *12 March Advice* at [18].

preliminary view of the Commission, it is unclear to what extent it adjusts Commission thinking on MEA selection set out in previous papers.

- C25 On that basis, we consider that the Commission has not provided a clear or consistent explanation of the basis upon which an MEA will be selected. At best, it has identified the non-exhaustive criteria that it may have regard to when identifying potential MEA candidates. In particular, as noted above, the Commission has not explained to parties the considerations that it will have regard to when deciding between competing MEA candidates. By way of illustration, as the 12 March advice recognises, different considerations in terms of section 18 of the Act are likely to apply depending on the MEA that is selected in terms of, for example, utilisation of existing infrastructure, cost minimisation incentives, investment incentives and replicating competitive market outcomes.<sup>15</sup> Input from parties should inform the Commission's consideration of each of these factors. But again, this the 12 March Advice does not represent a Commission preliminary view and parties therefore have no clarity as to whether, and if so how, the Commission might take these factors into account.

### **The significance of the MEA selection**

- C26 The MEA that is selected by the Commission will significantly influence the TSLRIC outputs of the FPP processes; it will necessarily define the scope of TSLRIC modelling that TERA is undertaking for the Commission.
- C27 As we understand it, TERA does not consider it possible to undertake TSLRIC modelling using multiple MEAs within the 1 December timeframe, although it accepts modelling multiple MEAs could feasibly be done if sufficient time were available. Moreover, we understand that the agreement under which TERA is providing consultancy services to the Commission specifies dates by which certain elements of its analysis must be completed.
- C28 We assume that the Commission intends to select the MEA to be used in TSLRIC modelling very soon. Given the Commission's commitment to its 1 December timeframe, for the following reasons this decision appears to us to constitute an 'irrevocable choice':
- (a) The Commission's reasons for MEA selection will be included in the draft pricing review determinations that the Commission plans to issue on August 2014.<sup>16</sup> The submissions process for the draft determination(s) will not be complete until mid-September.
  - (b) The Commission cannot exclude the possibility that submissions will raise genuine issues regarding its selection of an MEA that it will need to address. This could include disagreement regarding the factors considered when selecting an MEA, the relative weight given to these factors and so on.
  - (c) However, given the proximity between completion of the submissions process and the Commission's timeframe for the final pricing review determination(s), it seems to us most unlikely that the Commission could take account of these submissions in any meaningful way.

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<sup>15</sup> James Every-Palmer *12 March Advice* at [22].

<sup>16</sup> Section 47 and 49(a)-(c) of the Act.

- (d) In particular, the terms on which we understand the Commission has engaged TERA mean that it will have no practical ability to revisit or alter TSLRIC modelling work to any significant extent.
- C29 To illustrate, there is every prospect that the Commission, having selected an MEA well in advance of publishing its draft determination(s), will receive submissions arguing that the particular MEA selected generates outcomes that are inconsistent with section 18 of the Act (see paragraph C25 above). Such submissions may be convincing or they may not. The point is that having received these submissions the Commission is bound to consider them and, if it finds they have merit, alter its analysis to account for them.<sup>17</sup>
- C30 As the Commission is well aware, a failure to engage properly with persuasive evidence provided during the submissions process would create substantial risk to its final determination(s). In short, making an irrevocable choice without adequate consultation, in circumstances where later consultation confers no practical ability to influence or alter that choice, is unlikely to provide a basis for any enduring industry settlement.
- C31 Ultimately, even if the Commission's arrangements with TERA do not foreclose reconsideration at this point, deferring consultation on the Commission's MEA selection decision to the draft determination introduces a significant threat to the Commission's 1 December 2014 timeframe for completion. In reality, we expect that the Commission would feel itself compelled to properly engage with arguments contained in draft determination submissions, even if this means extending its timeframe and revisiting analysis already completed.
- C32 Vodafone reiterates that the Commission's guiding principle in conducting UBA and UCLL price reviews should be ensuring a robust and analytically rigorous process. Seeking to conclude both reviews by 1 December is most unlikely to deliver the Commission's goal of providing certainty to the industry; it simply increases the prospect that processes will play out in other fora.
- C33 As set out below in section H, we think that the Commission's 1 December goal can be reconciled with process risk to some extent if it issues an interim consultation relating setting out its proposed choice of MEA for both UCLL and UBA FPP processes, together with its (definitive) reasoning as to the factors it has considered in both identifying MEA candidates and selecting between them. This further consultation step strikes us as far preferable to a scenario in which parties are confronted with a clear and reasoned statement of the Commission's reasoning on MEA only at draft determination stage, and can provide submissions that inform MEA selection only at a point where they are incapable of being taken into account in any meaningful way.

## **D Relativity between UCLL and UBA**

- D1 The 12 March Advice notes that:

*...the UBA service and UBA backhaul allow an access seeker to provide a broadband service without using its own equipment. This menu allows an access seeker to decide "whether to build or buy" and to pick and choose particular parts of the network to access. This is sometimes referred to as the "ladder of investment".*

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<sup>17</sup> More fundamentally however, the Commission is likely to face real difficulty in deciding whether the selection of a particular MEA candidate better gives effect to section 18 purpose than selection of an alternative MEA candidate where it has not examined how selection of alternatives might affect TSLRICs relative to the MEA actually chosen.



*In my view, it is arguable that the existence of this structure indicates a statutory intent that the Commission should set prices for the individual designated access services in a manner that preserves appropriate relativities for build/buy decisions. I also note that the Act specifically requires the Commission to consider the relativity between the two services (s 19(b) and Schedule 1) in setting UCLL and UBA prices.*

- D2 The Act imposes a mandatory consideration for the Commission to consider relativity between the UCLL and UBA service in setting the UBA price. However, this requirement must be read in conjunction with s 19 of the Act, which ultimately requires the Commission to make a decision which best gives effect to s 18 of the Act.
- D3 While “build or buy” incentives are appropriately considered as part of this analysis, our view is that applying pricing for both the UCLL and UBA services that conform to the principles of TSLRIC is most likely to promote the long-term benefit of end-users. In conducting such an analysis (absent the final outcomes of the yet to be undertaken modelling exercise) we note that:
- (a) in terms of static efficiencies, there is no obvious justification for higher UBA prices;
  - (b) in terms of dynamic efficiencies, in a context where two competing access networks exist (i.e. copper and fibre), any case for ensuring price relativity in order to promote competition for the long-term benefits of end-users is further reduced. On this point we agree with Professor Martin Cave in his analysis for Chorus in relation to the Telecommunications Regulatory Review: This is a point noted by Martin Cave in his report for Chorus in the context of the Telecommunications Regulatory Review:<sup>18</sup>

*The introduction of the possibility of horizontal as well as vertical movement on the ladder changes things. Given that the fibre access point in New Zealand is likely to be a bitstream product, it is unlikely that New Zealand end users will be benefited by discouraging investment which first takes the retail service provider very close to the customer and then back again.*

In our view, this reflects a market context where service providers should be expected to “move across” to a new ladder of investment (i.e., from copper to fibre, as opposed to continue investment in the legacy network). This consideration is also relevant, we think, in terms of MEA selection.

- D4 Finally, we note that inflating UBA prices (to create additional head-room between the UBA price and the UCLL price in order to promote “efficient build or buy incentives”) in the interests of relativity would have no principled basis and would not be reconcilable with the scheme of the Act. It would not in fact promote efficient build or buy incentives. Instead, it would have the effect of promoting *inefficient* build or buy incentives, because prices would not reflect the efficient costs other required by the final pricing principle. Accordingly, such an outcome seems unlikely to be consistent with the long-term benefit of end-users.

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<sup>18</sup> Professor Martin Cave *Regulating the price of copper in New Zealand* (advice for Chorus, 13 June 2012) at page 14.

## **E A constructive approach to confidentiality**

### **Workable solution agreed between parties**

- E1 Vodafone has had preliminary conversations with various parties about a joint proposal to the Commission on how best to approach confidentiality. We are grateful for the constructive approach of the parties we have so far engaged with, and it is our intention to work toward a joint-proposal for the Commission as quickly as possible.

### **Final approach must allow access to certain internal advisors**

- E2 Vodafone notes that the Commission proposes to put in place a confidentiality order, issued under s 100 of the Commerce Act 1986, to govern access to confidential information. Vodafone welcomes the preliminary indication of how the Commission intends to approach this during the 28 March workshop, and intends to participate in the forthcoming consultation on the s 100 orders.
- E3 Vodafone very much hopes that the content of a s 100 order can be settled by agreement between the parties. However, we are strongly opposed to a confidentiality process that would limit access to confidential information to external counsel only. In our view this would:
- (a) drive significant cost and complexity for interested parties wishing to engage with the key assumptions which will necessarily underpin the TSLRIC model;
  - (b) prevent parties from leveraging the (often unique) expertise, especially in relation to network services and cost modelling, which already exist within their organisations;
  - (c) increase the difficulty for interested parties to adequately engage in what is already a tight timetable; and
  - (d) would be inconsistent with both past processes handling confidential information (where certain, nominated, internal advisors have been permitted to access confidential information) as well as the process adopted in other domains (such as due diligence), where parties have consistently demonstrated their ability to deal with confidential information in an appropriate manner.

## **F Backdating**

### **Backdating is discretionary**

- F1 The advice prepared by James Every-Palmer dated 24 March 2014 (the **24 March Advice**) draws the following conclusions:
- (a) the Act does not require backdating where a price set for the UBA or UCLL services under FPP processes differs from a price then pertaining in the market;
  - (b) the Commission has discretion whether or not to backdate;
  - (c) the exercise of discretion will be informed by a number of relevant factors. Of these, the purpose statement in section 18 of the Act will provide the most important guidance.

The Commission will also need to consider the direct and indirect effects of any decision that a price set via FPP processes should apply retrospectively; and

- (d) the Commission should not make a final decision on whether backdating should occur before completing all analysis necessary to support determination(s) pursuant to FPP processes.

F2 We agree with these conclusions.

### **Towards a framework for determining whether or not backdating should apply**

F3 As the 24 March Advice recognises, there is no generally applicable presumption that, where the Commission replaces an IPP price with an FPP price, the latter should apply as a matter of course in any preceding period during which the former applied.

F4 Proper interpretation of the Court of Appeal's judgment in *Telecom v. Commission*<sup>19</sup> (the **Court of Appeal judgment**) indicates that the Commission has discretion as to whether to backdate. A decision about whether backdating is appropriate must be made by Commission having had regard to all relevant factors. A decision must also be reasonable in the sense that it must be properly supported by the evidence before the Commission. But we respectfully submit that the Court of Appeal's judgment does not provide any indication as to how discretion ought to be exercised; nor does it create any general presumption in favour of backdating or operate to increase the evidential threshold or impose a 'proportionality test' that the Commission must meet to show that a decision not to backdate is reasonable.

F5 In determining whether it is appropriate to exercise its discretion to backdate an FPP, the Commission must make a decision that it considers best gives, or is likely to best give, effect to the purpose set out in section 18 TA01.<sup>20</sup> The Commission's primary duty under section 18 is *"...to promote competition in telecommunications markets for the long term benefit of end-users of telecommunications services."*

F6 In discharging this duty, the Commission must have regard to mandatory considerations<sup>21</sup> and any additional relevant considerations. Consideration of these factors will assist the Commission in exercising its primary duty in section 18(1) but cannot alter or displace that duty. In this instance, the following additional (non-mandatory) considerations are likely to be relevant to a decision as to whether to backdate an FPP price:

- (a) **Market structure effects:** The Commission must consider the extent to which backdating would alter market structure in a way that weakens competition. For example, if backdating were to impose retrospectively higher wholesale copper prices on retailers,

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<sup>19</sup> *Telecom New Zealand Limited v. Commerce Commission* CA75/05 (25 May 2006).

<sup>20</sup> Section 19(c) of the Act.

<sup>21</sup> Specifically:

- (a) section 18(2) of the Act, which provides that *"...the efficiencies that will result, or will be likely to result, from that act or omission must be considered"*;
- (b) section 18(2A) of the Act, an avoidance of doubt provision which requires consideration to be given to *"...incentives to innovate that exist for, and the risks faced by, investors in new telecommunications services that involve significant capital investment and that offer capabilities not available from established services"*; and
- (c) Subpart 1 of Part 2 of Schedule 1 to the Act, which requires the Commission to consider *"...relativity between [the UBA service] and Chorus's unbundled copper local loop network service..."*

then the Commission must consider any possibility of exit by retailers who are unable to pay and the resulting loss of retail competition that this would cause.

- (b) **Market behaviour effects:** Even if backdating would not alter market structure, the Commission must consider how a retrospective price change would affect competitive behaviour in retail markets. Retail telecommunications markets are highly competitive, as the Commission knows by virtue of its consideration of these markets through a range of regulatory activities and its ongoing monitoring work.<sup>22</sup> A recent IDC Market Analysis Note observes generally that “[t]he level of competition within the market has increased over the last year as operators compete on price and value.”<sup>23</sup> If backdating were to retrospectively impose higher costs on RSPs, this could reduce the intensity of competition in terms of service innovation and price that currently characterises the industry. In other words, even if backdating did not affect market structure, it could significantly impact current and future patterns of competition – and lead to a reduction, or at least a distortion, of competition in retail markets.
- (c) **Incentive for pass through exists only on one side of the market:** The Commission’s primary duty under the Act is promoting competition in telecommunications markets for the long term benefit of end-users. The duty must be accounted for by the Commission when considering whether to exercise discretion in favour of backdating. Retail telecommunications markets are highly competitive and pass through of any reduction in wholesale copper prices should be assumed. This is a view that has previously been endorsed by Chorus’ expert advisers: “...there can be no doubt that a reduction in wholesale copper prices will flow through to retail prices...”<sup>24</sup> In contrast, Chorus does not face competition in the supply of UBA and UCLL services, and higher prices for these services are unlikely to translate into benefits for end users. Lack of competition means that Chorus is effectively insulated from incentive to reduce wholesale copper prices (which is, after all, the rationale for regulation of these prices). Moreover, higher wholesale copper prices are unlikely to lead to innovation or investment in copper services (given Chorus’ agreement to minimise ongoing investment in copper access assets<sup>25</sup>) or in fibre services (given the services Chorus is expected to provide are specified in contract, with no obvious incentive to deviate from the current service description).
- (d) **No case for backdating absent economic harm:** A difference between IPP and FPP prices creates a notional wealth transfer between parties. However, unless economic harm has occurred as a result of this wealth transfer then it does not operate against the promotion of competition in telecommunications markets for the long-term benefit of end-users of telecommunications services. We submit that it is not reasonable or proportionate to require retrospective payments to be made by either Chorus or RSPs when no evidence of economic harm exists. The burden should be on any party arguing in favour of backdating to demonstrate, with reference to compelling evidence, that actual economic harm will occur if an FPP price is not backdated.

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<sup>22</sup> Commerce Commission *Annual Telecommunications Monitoring Report 2012* (April 2013).

<sup>23</sup> IDC Market Analysis *Too Big to Fail: IDC NZ Telecommunications Market Analysis and Forecasts 2013-2017* (September 2013), page 3.

<sup>24</sup> Dr Ross Patterson *Report to Chorus on Telecommunications Regulatory Framework 2020* (12 December 2013) at [5.10].

<sup>25</sup> Chorus’ Network Infrastructure Project Agreement (24 May 2011), Schedule 2, Clause 4(c).

- (e) **Implementation of backdating must be practical and workable:** If the Commission is minded to exercise its discretion in favour of backdating, it must ensure that the mechanism by which retrospective application of pricing occurs, and payments made between parties pursuant to this, can be practically and workably implemented. This consideration would be particularly relevant if the Commission were minded to adopt a 'partial backdating' approach, a possibility suggested in paragraph 11(e) of the 24 March Advice.

F7 While the Commission intends to complete the FPP processes before 1 December (rendering the question of backdating null), should it appear that the determinations are unlikely to be completed by that date, then we suggest it would be appropriate for the Commission to consult on its framework for assessing whether or not back-dating should apply prior to its final determination.

#### **An approach to "partial backdating"**

F8 The 24 March Advice concludes that the Commission has discretion to "partially backdate" the FPP prices. We agree with this conclusion, but believe that further consideration of what amounts to "partial backdating" is required.

F9 In our view, an approach which ensured that any under- or over-recovery was addressed on a smoothed, go-forward basis (such as the approach taken for claw-backs under Part 4 of the Commerce Act 1986) is more likely to deliver outcomes consistent with s 18 of the Act, than approach which requires either access seekers or the access provider to make a lump sum payment.

## **G Additional matters**

### **Aggregation of prices**

G1 Vodafone is not in principle opposed to further aggregation of the prices of regulated services. However, we consider that this conversation is more usefully conducted in the context of a completed model (allowing a proper understanding of cost allocation) and engagement with the actual translation of the network prices delivered by the model to the particular regulated services.

### **Duct and pole sharing**

G2 The Commission's expert consultants have indicated that its model is likely to incorporate duct and pole sharing based on assumptions driven by Chorus' actual practices. We do not consider that this appropriately reflects the requirements of TSLRIC modelling. Instead, the Commission should ensure that the model gives effect to an efficient level of sharing. Vodafone considers that this could be supported by:

- (a) assessing the level of infrastructure sharing adopted by other fixed operators in New Zealand (i.e., other UFB operators and with Vodafone's HFC network);
- (b) assessing commercially available infrastructure sharing offers (for example, Vodafone understands that Vector provides access to certain infrastructure to access seekers on commercial terms);

- (c) consideration of the approaches proposed by unsuccessful UFB candidates (such as Vector);
- (d) consideration of the actual sharing between Chorus' copper and fibre networks.

### **Information requests**

- G3 We understand that the Commission has so far issued compulsory information requests to only Chorus and Vodafone. In our view there is considerable information which would support the Commission's decision-making on the most efficient approach to network investment that could be obtained by expanding the Commission's information seeking beyond these two parties.
- G4 We consider that it would be appropriate to seek information from, for example, other mobile and fixed telecommunications service providers (such as Telecom), providers of commercial and other fibre services (such as Vector) and the LFCs.

### **Customers outside of UCLL/UBA coverage**

- G5 Vodafone notes that customers who are not currently able to be served by the UCLL/UBA service should be excluded from the modelling exercise. To the extent these customers are TSO customers (receiving, for example, voice services) it is clear that these services could be more efficiently provided using wireless or satellite technologies.

## **H Consultation process and timeline**

### **Our recommended approach**

- H1 The Commission has indicated that it intends to release on 19 August 2014:
  - (a) the draft determinations for both the UBA and UCLL final pricing principle; and
  - (b) the cost model prepared by TERA (and the supporting documentation).
- H2 We understand that no further consultation (excepting cross-submissions in the current consultation phase) is anticipated prior to the release of the draft determinations, and that interested parties will have 20 working days to prepare submissions, and a further 10 days to prepare cross-submissions on the draft determination.<sup>26</sup>
- H3 In our view, this is not reasonable timeline for parties to review and respond to a draft decision while simultaneously understanding and reviewing a model (and all of the assumptions which underpin it) for the first time. The Commission proposes to spend the next 4 months developing the model and draft determination. Parties wishing to make meaningful, informed submission on the model and draft determination will need to engage with issues of significant complexity, and must be afforded the opportunity to fully understand the Commission's reasoning and test its thinking (including, where necessary, by reference to independent expert analysis), yet the Commission has allowed only a little over 1 month for industry to review and comment on those conclusions.

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<sup>26</sup> We understand the Commission considers it is bound under the Telecommunications Act 2001 to complete consultation on the draft determination within 30 working days.

- H4 In our view, the challenges that this will likely give rise to may be resolved by the Commission:
- (a) issuing a consultation document prior to the commencement of modelling identifying the key decisions it has taken (including reasons) and the final instructions it has issued TERA for the development of the TSLRIC cost model.<sup>27</sup> This document would not need to be materially different to the “riding instructions” the Commission will otherwise be required to provide TERA; and
  - (b) releasing and consulting on a copy of the model (and its supporting documentation) at least six weeks prior to the release of the draft determination.
- H5 While Vodafone, for the reasons set out below at [H6] – [H15] does not consider that it is essential for the Commission to achieve a final determination by 1 December, it is likely that our proposed approach could still be consistent with this timeline.

#### **Achieving a final determination by 1 December 2014**

- H6 The Commission has confirmed that it will complete FPP processes for the UBA and UCLL services by 1 December 2014.<sup>28</sup>
- H7 We understand that this timetable is driven in part by a desire to provide Chorus and RSPs with price certainty. This is reflected in the Commission’s UBA process and issues paper as follows:
- If the UBA price review determination is not completed by 1 December 2014, the prices we have already determined under the IPP will take effect on that date. The UBA price may subsequently change, once the FPP price is set under the UBA price review determination, which will result in a longer period of uncertainty for the market. If we do not determine an FPP price by 1 December 2014, an issue arises as to whether we will backdate, which will create further uncertainty.<sup>29</sup>*
- H8 We also note that where an application is made for review of the UBA price determined by the Commission pursuant to ss 77(1)(a) and 30R of the Act, it must make reasonable efforts to complete the pricing review determination before the expiry of 3 years from separation day (i.e., by 1 December 2014).
- H9 None of these considerations operate to impose a mandatory deadline on the Commission.
- H10 We find the Commission’s reasoning on the case for a 1 December deadline unconvincing. Given the importance and financial implications of any decision reached, there is every prospect that matters will play out in other fora. If the duration of the Commission’s decision-making process, which will necessarily influence the scope of analysis undertaken within this process, is arbitrarily constrained then the likelihood of appeals, and success on appeal, increases. If the Commission determines FPP prices that are subsequently ‘corrected’ on appeal for whatever reason, the industry will confront any uncertainty associated with backdating at that point. It is not avoided by meeting a 1 December deadline.

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<sup>27</sup> See also the discussion above, in relation to the importance of MEA selection, at [C26] – [C33].

<sup>28</sup> Commerce Commission *Commission confirms UCLL and UBA decision by December* (media release, 28 March 2014).

<sup>29</sup> Commerce Commission *UBA Issues Paper* (7 February 2014) at [10]. In addition, as observed in the Commerce Commission *UCLL Process and Issues Paper* (6 December 2013) at [17]: “... there are uncertainties arising from taking a longer period of time to reach a decision.”

- H11 In Vodafone's view, the Commission's primary objective in completing the FPP processes for the UBA and UCLL services should be to ensure that its FPP price determinations provide an enduring industry settlement, and that uncertainty arising from these determinations themselves is reduced as far as possible. Securing this objective has the following key elements:
- (a) the Commission must determine FPP prices on the basis of the best possible information;
  - (b) the Commission's analysis of that information must be robust and reasonable. It is recognised that there must be limits to the extent of analysis. But any limits to analysis should not be arbitrary. Where issues arise that are material to the Commission's analysis, they must be properly engaged with. In Vodafone's view, it would not be acceptable for the Commission to decline to properly engage with issues that raise genuine questions, for example, simply because they add complexity to FPP processes or because completing the analysis required to address issues is inconsistent with the 1 December timeframe;
  - (c) the process adopted by the Commission in reaching its determinations must be reasonable and transparent.
- H12 Vodafone appreciates the open and transparent manner with which the Commission has engaged with industry to date in the FPP processes. We also accept that decision making processes, and consultation within those processes, cannot be open-ended.
- H13 However, we find it difficult to accept an approach whereby the Commission determines *ex ante* that its "...proposed process seeks to strike the right balance between the various tradeoffs given the circumstances that surround the UBA price determination ...".<sup>30</sup> This strikes us as a judgement that is impossible to make in the abstract, without prior knowledge of the actual issues that might need to be balanced through a decision making process. It follows that we simply do not understand the basis on which the Commission can, based on an *ex ante* definition of its preferred process, decide that "...it is desirable that we aim to complete the FPP before 1 December 2014."<sup>31</sup> Upfront selection of a particular process should not determine the nature and scope of the analysis that the Commission is prepared to conduct in order to reach strong and robust conclusions, or the time available to complete this.
- H14 We have an emerging concern that timetable considerations are being given inappropriate weight by the Commission in making some analytical choices. It is apparent that the Commission has a high level of commitment to the 1 December deadline. Our concern is that this commitment may result in:
- (a) the Commission limiting the breadth of questions it will ask itself (and/or ask its advisers to address) when determining FPP prices, and in particular when identifying the appropriate MEA;
  - (b) the Commission being reluctant to engage with and address questions raised by parties involved in FPP processes;

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<sup>30</sup> Commerce Commission *UBA Issues Paper* (7 February 2014) at [12].

<sup>31</sup> Commerce Commission *UBA Issues Paper* (7 February 2014) at [12].



- (c) the truncation of information gathering processes, and the time available for consideration and interrogation of information gathered; and
- (d) challenges to some parties' abilities to engage as fully in FPP processes as they would wish to.

H15 We consider the approach we have set out above, at [H1] – [H5] may provide a workable solution to resolve these issues.