

TELSTRACLEAR: WEALTH TRANSFERS

A. Contentions of Telecom and Vodafone

1. Telecom and Vodafone oppose the Commission's approach. They place reliance on:
 - (a) the so called "established practice" of ignoring wealth transfers (which is in fact confined to CBA's under Part V of the CA); and
 - (b) what they describe as settled law in the recent judgment of the High Court in the *Air New Zealand/Qantas case* decided under that Part of the CA.

2. There are a number of fundamental errors running through these contentions:
 - (a) A failure to recognise that this issue is primarily one of law not economics;
 - Berry's reference to first principles
 - (b) A failure/refusal to give recognition to the distinction between:
 - (i) A public benefit test (such as applies under Part V of the CA); and
 - (ii) A consumer/end-user benefit test (such as applies under Part IV of the CA and section 18 TA).
 - (c) A failure/refusal to give recognition to the differences between the TA and the CA;

B. Economics v Law

3. The law and not economics governs this issue: *Bank of Tokyo v Karoon* [1986] 3 All ER 468 at 486; *Re Polly Peck International plc (in administration)* [1996] 2 All ER 433 at 444.

4. The TA was passed to rectify market failure. The Commission must not compromise that objective by allowing the Act to be hijacked by economics. In particular economic theory (or Telecom's view of it) must not be allowed to deprive the Commission of its mandate under section 18 to take wealth transfers into account. The quantification of those transfers and the weighting to be given to them is a matter of judgment.
5. TelstraClear has submitted reports from Dr Geoff Bertram in which he concludes that a consumer surplus test is more appropriate than a total surplus test from an economic perspective. Dr John Small expressed a similar view in his review of the Commission's Final Report on LLU for the Ministry of Economic Development.
6. The existence of conflicting economic theories cannot be allowed to compromise the unambiguous language of the Act

C. Public benefits test v end user

7. There is a clear distinction between public benefits test and end user test.
8. Distinction illustrated by distinction between Parts IV & IVA and Part V of the CA.

Part IV

9. Part IV of the CA provides a relevant analogy to support the Commission's position on wealth transfers, as it prescribes a consumer/end-user benefit test:
 - (a) Section 52 permits price control if this is necessary or desirable in the interests of "*persons acquiring*" the goods or services in question and if there is limited competition for those goods or services.
 - (b) The section provides a relevant analogy because:
 - (i) "interests of persons acquiring" is a similar, albeit not identical form of consumer benefit test to "benefit of end

users” (compare definition of “acquire” in section 2 of the CA with the definition of “end users” in section 5 of the TA);

- (ii) Part IV of the CA provides for the price control of goods and services on the recommendation of a Government Minister, with advice or a report from the Commission.
10. In inquiries under Part IV of the CA the Commission has taken account of wealth transfers from “suppliers” to “acquirers”:
 - (a) Final Report on Inquiry into Airfield Activities at Auckland, Wellington and Christchurch International Airports (paragraphs 14, 76, 97 to 101, 2.31, 2.32, 2.39, 2.53, 2.56 to 2.63 and 8.248);
 - (b) Draft Report in the Gas Control Inquiry (12, 1.16, 2.19 to 2.25, 2.43, 2.46 to 2.49, 2.101, 4.2, 4.3, 6.1 and 6.2).
11. Telecom and Vodafone have refused to recognise the approaches taken by the Commission in these Inquiries under Part IV of the Act, notwithstanding their direct relevance to the application of any statutory consumer benefit test, such as that under section 18 of the TA.
12. Telecom relies on the absence of the “long-term” qualifier in section 52. Although Part IV omits reference to the phrase “long-term”, this is a tenuous basis on which to base its contentions. The relevance of the analogy with Part IV is the distinction that the Commission has made between “acquirers”, “consumers” and “end users” on the one hand and the “public” on the other, which is a larger audience and includes producers.
13. They also suggest that Parts IV and IVA is concerned with a different objective. Yet they rely on *AIR New Zealand/Qantas*, which was decided under Part V. Parts IV and IVA are close analogies to the TA. Section 66 and Schedule 3 of the TA provide for the regulation of telecommunications services (a form of price control between access providers and access seekers). Part V is distinctive.
 - Bruce Gray reference to Part IV

Part IVA

14. Part IVA of the CA provides for the Commission to declare that goods or services supplied by a large electricity lines business are controlled. It also provides a relevant analogy.
- (a) It provides for the regulation of the distribution and transmission of electricity. Section 57E states that the purpose of this subpart is to “*promote the efficient operation of markets ... through targeted control for the long-term benefit of consumers*” by 3 specific means.
 - (b) “*long-term benefit of consumers*” is a similar albeit not identical consumer benefits test to “*long-term benefit of end users*”. It is noteworthy that Part IVA includes the qualifier: “long-term”.
15. Although there are differences between section 18 of the TA and section 57E of the CA, those differences are not material to the issue of whether the Commission may take wealth transfers into account.
16. A key difference between these provisions is that Part IVA identifies the means by which long-term benefits of end users are to be promoted by price controls. They are:
- (a) Limit suppliers ability to extract excessive profits;
 - (b) Ensure suppliers face strong incentives to improve efficiencies and provide quality that reflects consumer demands;
 - (c) Ensure suppliers share benefits of efficiency gains with consumers, including through lower prices.

These mechanisms facilitate wealth transfers from producers to consumers. They reflect a proxy for the outcome of effective competition, and reflect a consumer surplus test.

17. Section 18 does not contain these mechanisms, as they are included within the operative provisions of Part 2 and Schedules 1 and 3. Section 18 of the TA merely refers to the promotion of competition. This distinction does not diminish the direct relevance of the

Commission's application of a consumer benefit test to include wealth transfers in its CBAs.

Part V

18. Part V has a public benefit test.
19. Telecom and Vodafone suggest there is an established practice of The Commission's Guidelines to the Analysis of Public Benefits and Detriments are expressly directed at applications for authorisations under Part V of the CA for mergers/acquisitions and restricted trade practices. As noted above, and in the Guideline itself, Part V incorporates a public benefit test. Therefore the Guidelines have no application to section 18 of the TA.

D. TA v CA

20. Although Parliament intended to align many of the concepts in these two Acts there are significant differences between them that must be respected:
 - (a) Different legislative history;
 - (b) Quite different provisions – section 18 and Schedule 1
21. If Parliament had intended that the TA incorporate a public benefit test, it would have done so using phrases similar to Part V of the CA. However this would conflict with its intention to eliminate the *Baumol-Willig* rule and introduce forward looking cost based prices.

Legislative history of the TA

22. Where the meaning of a provision within an Act is uncertain, the Court may consider the Parliamentary history of the Act: *Marac Life Assurance Ltd v Commissioner of Inland Revenue* [1986] 1 NZLR 694, 701 (CA) and *New Zealand Maori Council v Attorney-General* [1987] 1 NZLR 641, 658 (HC and CA)).
23. While both TA and CA are directed at the promotion of competition for the benefit of consumers and efficiencies:

- (a) The CA is directed at industry generally.
- (b) The TA is confined to the telecommunications industry with its own dynamics (incumbent ubiquitous networks resulting in a history of opportunity cost based prices) and limited or absent competition, leading to incumbents making economic profits at the expense of consumers (see pages 13 to 27 of the Fletcher Report).
 - One key objective of the TA is to drive out economic profits through the regulation of forward looking cost based pricing in substitution of the *Baumol Willig* rule, which rule continues to apply under the Commerce Act.

24. The Fletcher Report contains passages that reflect an understanding that the Act would incorporate a consumer benefit test that would take wealth transfers into account:

- (a) On page 50 of the report the Inquiry noted:

“The Inquiry was also criticised by some submitters for appearing to give consumer welfare higher weighting than producer welfare. This criticism was directed at the access objective, in particular the inclusion of the words “long-term interests of end users”, which some submitters suggested were biased against suppliers in favour of consumers.

The Inquiry does not agree with this view. Any inappropriate compromise or bias against producer surplus would not be in the long-term interests of end users. Further, as noted above, all of the elements of the objective require efficiency, such as efficient competition or efficient investment, which the Inquiry consider protects the long-term interests of providers. The Inquiry notes that innovative and efficient competition in electronic communications services, which its recommendations are designed to support, will create opportunities for producer surplus through efficient investments in the supply of innovative services. It will also erode that surplus away over time through competition, which will likely set the stage for further innovation.”.

- (b) On page 54 the Inquiry referred to the benefits of regulating Telecom’s local loop. It referred to a report from CRNEC, in which the costs and benefits of regulating some of these services were estimated:

“...the net effect of the [Inquiry’s] proposals will be to increase aggregate welfare by \$43.9 million per annum. This is a pure welfare gain. Equivalently, it is an estimate of the amount of the surplus that we have lost over the last 12 months as a result of not having the proposed regime in place. In addition to this pure welfare gain, [CRNEC] expect that consumers will be better off by \$328 million per annum.”

- (c) On page 63 the Inquiry made further reference to welfare transfers from Telecom to end users:

“CRNEC has estimated the benefits of cost based access to Telecom’s network (in terms of allocative efficiency alone) to be in excess of \$42 million a year. In addition, CRNEC estimates a welfare transfer from Telecom to end users of \$208 million per year in such circumstances.”

25. During the second reading of the Bill, the Hon David Cunliffe observed:

“Most important, the purpose clause in Part 2, clause 15, has been brought into line with the purpose of the Commerce Act, and that is a very, very important streamlining of this bill, It clarifies that consumer welfare is the overall objective of this bill. It also makes clear that competition is the primary basis for calculating that welfare. Of course, there are efficiency sub-tests, as there needs to be, and that is in line with the Commerce Act.”

Section 18 of the TA

26. Section 18 prescribes the purpose of the Act as being the promotion of competition in telecommunications markets for the long-term benefit of end users.

27. When interpreting this section, the Commission must have regard to the following principles – or first principles:

- (a) The starting point for the interpretation of an Act is considering the natural and ordinary meaning of the Act in question: *Read v Read* [1992] 1 NZLR 147, 149-151 (PC). The onus on a person who seeks an interpretation different to the ordinary meaning is a heavy one: *Accident Compensation Commission v Kivi* [1980] 2 NZLR 385, 389 (CA).

End user is defined in section 5, in relation to Telecommunication services, as a person who is the ultimate recipient of that service or of another service that depends on that service. The ordinary

meaning of the term excludes the provider of Telecommunications services.

- (b) The Court will seek to give a meaning to every word in an Act so there is no surplusage: *Re Dixon (No 2)* [1960] NZLR 825, 826 (SC); *Re Peter Austin Ltd* [1990] 2 NZLR 245, 253 (HC).

The term “end user” is distinct from the “public”. Accordingly, the phrase “long term benefit of end users” must be given meaning and application, and not rendered superfluous.

Schedule 1

- 28. Schedule 1 of the TA excludes the application of the *Baumol-Willig* rule and introduces forward looking cost based pricing. Parliament thereby implemented its policy of driving out economic profits generated from the supply of designated services by access providers in the telecommunications markets. The Act presumes pass-through of wealth transfers from access seekers and providers to end users, with the aim of reducing prices to consumers.
- 29. Telecom and Vodafone suggest the provisions of Schedule 1 have little or no relevance to an investigation under Schedule 3 as to whether mobile termination services should be designated. With respect, such a contention has no merit:
 - (a) Section 19(b) expressly authorises the Commission to have regard to Schedule 1 when applying section 18 of the Act;
 - (b) Interpretation of an Act requires it to be:
 - (i) read as a whole. This requires the enactment in question to be read in the context of “the scheme of the Act”: *Martin v Martin* [1979] 1 NZLR 97,110 (CA).
 - (ii) given a purposive construction: *Lowe v Commissioner of Inland Revenue* [1981] 1 NZLR 326,342 (CA).
 - (iii) interpreted in a manner that creates a workable or functional statute scheme: *Frucor Beverages Limited v Rio*

Beverages Limited [2001] 2 NZLR 604,613 (CA); *Nunns Licensing Control Commission* [1967] NZLR 730,745 (CA).

This includes the schedule to an Act which is part of the Act and may be an important guide to statutory interpretation: *Thomson v Burrows* [1916] NZLR 223, 226 (SC); *Eldorado Ice Cream Company Ltd v Clark* [1938] 1 KB 715.

(c) The purpose clause in section 18 applies to both determinations made under Part 2 and Schedule 1 of the Act and to investigations under Schedule 3.

(d) When applying section 18 to Schedule 3 investigations, it would be absurd to ignore the principles contained in Schedule 1, as they represent Parliament's understanding and intention of the outworking of the section 18. The schedule provides an illustration that is relevant to the interpretation and application of that clause to investigations under Schedule 3.

- This is particularly so for interconnection

30. The TA has no public benefit test, such as that under Part V. Sections 18 and 19 of the TA impose a statutory mandate on the Commission to make the recommendation that is likely to best promote competition for the long-term benefit of end users. It is therefore obliged to take wealth transfers to consumers into account.

E. Air New Zealand/Qantas case

31. While seeking to distinguish the relevant analogies provided by Parts IV and IVA of the CA, Telecom and Vodafone place reliance on Part V of the Act and the recent judgement of the High Court in the *Air New Zealand/Qantas case*.

32. This reliance is misplaced:

(a) The *Air New Zealand/Qantas case* concerns an entirely different Act, with a different history and function:

- (b) The *Air New Zealand/Qantas* case concerns an entirely different test – Part V public benefits (see Para 241);
- (c) The Court was faced with a potential inconsistency between the consumer benefit test under section 1A and the public benefit test in section 61. It was therefore required to interpret the Act in a manner that reconciled that inconsistency:
- (i) Prior to the enactment of section 1A of the CA, the Commission and the Courts regarded wealth transfers from producers to consumers as being neutral when assessing the “benefit to the public”. This was justified on the basis that “public” includes both NZ consumers and producers. Therefore transfers from one group to the other were considered not to create a net benefit to the public as a whole.
- (ii) Section 1A was enacted on 26 May 2001. In the *Air New Zealand/Qantas* case the High Court held that section 1A did not override the benefit of the public test in section 61 of the CA and did not disturb the Commission’s established practice of treating as neutral wealth transfers between NZ producers and consumers (at para 241).
- (iii) The Court attempted to reconcile section 1A and section 61 by reference to the need to balance efficiency detriments from transaction in question with efficiency gains from that transaction. It held that the balancing of these real resource impacts on the economy best served the long term interests of consumers:
- Confined to that case and that Part of the CA;
 - Under the TA long term end user benefits prevail (s19(c));
 - Ignored adhoc wealth transfers (ie one off).

- (iv) TelstraClear accepts the validity of the High Court’s conclusion regarding the interrelationship between sections 1A and 61. Section 1A is a general provision. It cannot override the specific “*benefit to the public*” test in section 61 of the Act for the purpose of Part V of the Act: *McCosh’s application* [1958] NZLR 731 at 734; *Allison v Kealy* [1968] NZLR 958 at 965/6.
- (v) Nevertheless, the Court and the Commission gave recognition to the distinction between “*benefits to the public*” as used in Part V and “*benefits to consumers*” as used in section 1A (para 240).
 - Although paragraph 240 of the judgment recites the contentions of the appellants and the Commission, it is clear from paragraph 241 that the Court accepted those contentions.

33. Two additional matters are noteworthy:

- (a) It is significant that the High Court did consider Parts IV and IVA of the CA and it did not conclude that the Commission was required to disregard wealth transfers when undertaking CBA’s under those Parts of the Act.
- (b) Paragraph 241 of the judgment represents the sum total of the Court’s judgment on this issue. It represents only 1 paragraph of 431 paragraphs that make up the judgment. The Court dealt with this issue in a fairly cursory manner and the paragraph must therefore be treated with some care. It cannot be taken to have gone as far as is suggested by Telecom/Vodafone.

Foreign owned producers

34. The relevant passage from the *Air New Zealand/Qantas* judgment states that the matter at issue is confined to wealth transfers within New Zealand and notes that transfers between New Zealand and other countries are not necessarily to be regarded as welfare neutral:

- (a) As both Telecom and Vodafone are foreign owned companies (80% Telecom and 100% Vodafone), the Commission is entitled to take account of wealth transfers from these producers to NZ end users. Such wealth transfers create a benefit to the NZ economy as a whole.
 - (b) This approach is supported by:
 - (i) The judgment of the High Court in the AMPS A case;
 - (ii) The Commission's Decision 511 (*Air New Zealand/Qantas*).
35. The issues raised in paragraph 120 of Vodafone's submission do not alter TelstraClear's position:
- (a) Functionless monopoly rents are capable of estimation.
 - (b) It is correct that the extent to which profits are repatriated to overseas shareholders may have an impact on the justification for regulation. This is inherent in the economic analysis.
 - (c) Shareholdings may change, although this is unlikely in the case of Vodafone and the proportion of overseas shareholdings in Telecom is reasonably stable. So may other factors, which is why the Act incorporates expiry dates for regulated services, to enable the Commission to periodically consider whether a service should continue to be regulated.

F. Other "official" views

36. Telecom's reference to the so-called settled approaches of Treasury and the Government are make-weight and not compelling. Treasury's view does not appear to be supported by legal advice.
37. The Commission is bound to form its own view on the interpretation and application of section 18. It is not permissible for it to be influenced by the views of Treasury and the Government. There is no evidence that the Minister shares Treasury's view on wealth transfers, or that he adopted its recommendation to ask the Commission to reconsider its

framework. Furthermore, the Ministry of Economic Development has stated that it considers that section 18 is a consumer surplus test (see Review undertaken by Dr John Small).