Wigley+Company solicitors

Submission on Further Draft Pricing Review UCLL and UBA Determinations

13 August 2015

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1. Summary

Dealing with submissions

1.1 As the Commission knows, the fact that it is not engaging in writing with all material submissions (our clients and, to be emphasised, those of the other RSPs) is a major issue for our clients. In the latest drafts, the Commission says it does not need to do this. The submission is still firmly made that, legally, that is required. the revised drafts are therefore not statutory draft determinations as they omit a required feature. It is submitted that compliant drafts must be produced to enable parties to adequately submit.

1.2 We demonstrate the problem with a case study: our 28 page 11 April submission which has not been dealt with anywhere in the 2 July documents. In particular, it is not dealt with in the attachment where the Commission states it is dealing with all submissions from the same time and on the same topic. The problems from this submission alone spread widely.

Section 18

1.3 Contrary to submissions, much of the Commission's application of s 18 is broadly based, rolled into briefly stated reasons, along with non s 18 reasons, to support a particular point, and lack the required supporting evidence and quantitative analysis. There are notable exceptions. The WACC uplift analysis (and to a lesser extent, the TSLRIC uplift analysis) provides a useful precedent for the type of s 18 evidence (including quantified analysis and CBA) that the Commission's decisions should be based on, contrasting to the impressionistic approach adopted elsewhere in the drafts (where the IM judgment clearly shows that an impressionistic approach is not permissible).

1.4 We remain of the view that, in order to comply with the Act, the Commission should carefully delineate three sequential steps:

(a) TSLRIC modelling and choices (based solely on seeking the price based on the least cost efficient network);

(b) Apply s 18 where there is a choice that cannot be resolved under TSLRIC methodology;

(c) Address a wash up in the end based on the central estimate, around a plausible range, to include adjustments (probably downward) to reflect upward distortions in the second step.

1.5 The "central estimate" is heavily influenced by upward s 18 adjustments yet it is still treated as a central TSLRIC assessment.

1.6 The analysis at the 2nd and 3rd steps must be real world evidence based (not hypothetical, contrary to the 1st step) and quantitative analysis is required.

WACC and TSLRIC uplift, and implications for other s 18 decisions

1.7 Whatever the Commission's view on engaging with submissions in writing, there is a clear error on this aspect as to the handling of our 11 April submission for the Commission to remedy. Our ability to submit is curtailed until this is remedied.

1.8 While the Oxera work especially is welcomed, we outline a number of issues, one of which is the need to quantitatively analyse and assess a downward price adjustment.

1.9 Section 18 choices (eg a choice between two models) predominantly are ultimately about choices that increase or decrease the price (or are neutral).

1.10 Thus, given that the quantitative analysis for WACC and TSLRIC uplifts demonstrate there is no ground to uplift the price, the same must apply to all other s 18 choices such as between competing models. On the current drafts there can be no justification for choosing the option that is upward biased.

Relativity

1.11 Over 6 pages of our 11 May submission were devoted to this issue (for which there needs to quantitative analysis too for the same reasons). The Commission has not dealt with this submission (and there is the strong appearance that this is so). That submission was lodged on behalf of the largest unbundler with considerable sums at stake. The Commission, in addition to a compliant draft as noted above, should rework the draft and reconsult.

UCLL Aggregation Model

1.12 We remain of the view that the aggregation model is not permissible under the Act.

Reasonable investor expectations, predictability and conventionality

1.13 Over various iterations, the Commission, in response to submissions, has altered its high level approach to downgrade the importance of reasonsable investor expectations, and, now predictability. But a review of the detail and in turn the outcomes (no material change in the modelling and price outcomes) indicates no real change. Still the same line is taken: just different words.

UBA fibre/FWA v copper MEA

1.14 It is submitted there is a pattern, identified by submitters, of the ultimate draft pricing remaining largely the same, and that, when the Commission realises it cannot rely on its original ground on an issue, it is replaced with another, drawing the same conclusion, but the new ground is strained – as reflected in the July drafts being 4 cents higher from the December drafts, despite substantive evidence that the December drafts overstated TSLRIC costs. Reasonable investor expectations, with close to a cut and paste insert of predictability and now another variant on the same theme illustrate this.

1.15 It is submitted that the approach taken to justifying retention of a copper UBA MEA is highly unsafe, and involves unusual contortions.

1.16 A fundamental part of choosing between MEA options is to quantify the different effects of each. The Commission has not produced for comment a critical document: its calculation that the costs flowing from a copper and fibre MEA are around the same. We can only meaningfully submit after that document is produced.

EUBA

1.17 Clients want this service at cost, and not on the current basis, which is not an available option under the legislation.

Backdating

1.18 There is a separate submission devoted to backdating.

Compliant draft determination sought

1.19 Throughout there are references to the Commission not having engaged in writing with submissions. And there are references to other shortfalls. We have not summarised these above, but they all involve substantial issues and substantial sums. Compliant draft determinations are sought, which deal with material submissions in writing.

Timing

1.20 This summary is closed with a short, but very concerned, reprise by our clients about the unsatisfactory speed and handling of this matter, with negative impacts set out in multiple submissions.

2. Commission's handling of submissions - a case study

2.1 From the commencement of the FPP determination process, consumer organisations and CallPlus have consistently submitted that the process was being conducted in undue haste and this would lead to errors and corner cutting. At the UBA/UCLL determination conference, Wigley and Co raised concerns on behalf of its clients that submissions were not being sufficiently responded to or addressed in writing as required by law. At the conference Commissioner Duignan indicated that this complaint would be addressed in future – consumer organisations consider it has not been addressed.

2.2 In this section we provide a clear example of the problems around the Commission's treatment of submissions. It is a manifestation, and a variant, of the deep concern that our clients have articulated multiple times.

2.3 On 11 May 2015, we provided a 28 page submission to the Commission, at the same time as other parties filed submissions, mainly focussed on the Commission's 2 April paper on TSLRIC uplift.

2.4 That submission contained detailed points on the Commission's 2 April paper and the CBA model in that paper. Some of the points are of similar nature to the submissions made by other parties and their experts, but there were multiple additional points. Our 11 May submission built upon our 13 April paper but covered additional issues and contained a great deal more material.

2.5 Attachment R in the UCLL draft determination is labelled, "Analysis of submissions on framework for considering a TSLRIC uplift". That includes our 11 April submission. Then Attachment R introduces the Attachment as follows:

> In this Attachment, we summarise the submissions received on the analytical framework we proposed in our 2 April 2015 paper for considering the potential welfare effects of an uplift to the UCLL price.

2.6 All submissions made by the parties and the experts are dealt with in Attachment R with the exception of our 28 page 11 May submission. (For completeness, we note that there are multiple points in that submission beyond those made in other submissions).

2.7 We can find no reference anywhere in the draft reports and associated material to our 11 May submission, which covers multiple points. For example:

(a) Our 11 May submission is relevant to both WACC uplift and TSLRIC Uplift;

(b) There is no reference to our submission in the Cost of Capital paper or the papers on uplift of Oxera and Professors Vogelsang and Cambini.

(c) It is clear that the material in (b) has had no regard to our 11 May submission. For example, the material in our 11 May paper is highly relevant to Oxera's consideration of WACC uplift but it clearly has not been considered. (To avoid doubt, there are also issues around the appearance of this, in addition to actuality: appearance/perception are legally relevant in this area.)

(d) Taking only one example, at Para 240 of the Cost of Capital paper, the Commission concludes that it can take into account total welfare as well as consumer welfare. It has not addressed the strong points against this at Para 4 of our 11 May 2015 submission.[1] It is readily apparent that our submission was not considered and dealt with for that purpose.

(e) Even clearer, the submission is not dealt with in Professor Cambini's 19 May paper, *Potential welfare gains and losses from an uplift of copper prices: A Reply to Companies' comments.* Our submissions are just as relevant for an economist to review as the submissions of Chorus, Vodafone, Spark and their experts that were dealt with by Professor Cambini. There were many submitted points on the economics and the modelling, beyond pure legal, as has always been the case. We dealt with issues involving all the topics he addresses.

(f) To another example: our 11 May submissions as to relativity have not been dealt either as to uplift questions or in other parts of the draft where relativity has been considered (In any event, there is a strong perception that this is so.) There are six pages where the relativity issues are strongly developed in the 11 May submission. The draft determination however deals only with the points in our 20 February submission. This has been provided on behalf of the largest unbundler (along with our other clients) and thus the party most affected by relativity. It appears not to have been considered, as none of this 11 May report is reflected anywhere in the Commission material.

Implications

2.8 As to the way the 11 May submission has been treated, we have not reviewed yet whether there are – beyond the statutory duty to give reasons dealt with in the next section – public law and statutory breaches requiring the Commission to re-consult (and, in any event, it is just an example). The position on that is reserved until the Commission deals with the following paragraph, this being an example of the submitted non-compliance with the Act.

2.9 Our clients have said on multiple occasions that, in the end, they just want to be treated fairly and openly, particularly as to the consumer NGOs which, relatively uniquely in regulatory matters, are providing a voice for the central concern of this process: the end-user. They incur a great deal of time, cost and energy in doing so, with no financial gain to be had for them.

[1] In the end, the Commission, in draft, concluded that it would only consider consumer welfare, but it has not dealt with our threshold issue that total welfare is not an option.

2.10 The Commission's observed approach has been to rely upon competing parties providing conflicting evidence which it can then adjudicate between. While this is a pragmatic approach it fails to recognise that the central focus of this process is the end-user who is not resourced to undertake detailed analysis. The Commission has a responsibility to not only adjudicate between well-resourced competing parties but to provide its own analysis in support of any conclusions it draws, having close regard to the interests of end-users.

3. The revised draft determinations are not a statutory draft determinations

3.1 The Commission has addressed in writing more of the submissions advanced by the parties than it has in the past, often in sufficiently comprehensive fashion. That is welcome although, to be clear, many of the references to submissions are incomplete and do not refer to all material aspects.

3.2 However, that leaves a great deal of submission and evidence that has not been addressed, or addressed adequately, in writing. Only one example of this is given in the above case study.

3.3 The Commission maintains that "we do not consider that in providing reasons as part of a draft (or final) pricing review determination that we are obliged to discuss or refer to all submissions made."[2]

3.4 Thus, the Commission rejected our detailed submissions[3] as to:

(a) the need to engage in writing, in the draft and in the final determination with submissions (described in one judgment as "substantive submissions" and variously described in other judgments), and

(b) the level and method of engagement with the submissions and reasons.

3.5 Consistent with the view that no written reasons have to be given on submissions, no reasons were given for rejecting the submission noted above, which, as the Commission is aware from multiple submissions, discussions and correspondence, is of central importance for our RSP and consumer clients.

Position as to the draft determination

3.6 We explained, in our submission,[4] why the duty to give reasons in the draft extended to responding in writing to the evidence and parties' earlier submissions. In particular, such detail enables the parties to submit meaningfully upon the draft, including as to submissions and evidence that has been rejected by the Commission in the draft. Our case study above presents an example of this: we have little to submit to, beyond what has already been said, as we do not know the Commission's position on our submissions.

Other parties' submissions

3.7 It is apparent that many of the other parties' submissions and evidence have also not been addressed or addressed adequately. This includes as to detailed factual issues in the modelling. Further, many of the steps and conclusions do

[2] Commerce Commission, Further draft pricing review determination for Chorus' UCLL service, 2 July 2015, paragraph 63.3.
[3] Wigley & Company, Cross submissions as to draft UCLL and UBA FPP determinations, 20 March 2015 Appendix A.
[4] Wigley & Company, Cross submissions as to draft UCLL and UBA FPP determinations, 20 March 2015, Appendix A, Para 27.

not have reasons given. As much of this is detail, involving expert economists, we will cross-submit on those issues based on what the other submissions have to say.

3.8 To avoid doubt, this submission does not address all points and omissions: the overriding submission is that the Commission has to adequately deal with all material submissions in writing in the draft and has not done so, and must provide a compliant draft determination on which there can be submissions. In light of this, all existing submissions by and on behalf of our clients, prior to the draft determination, remain "live" and this submission should not be taken as limiting the position: the difficulty is that the absence of dealing with submissions makes submitting in a different way too difficult.

Reliance on Commission dealing with other parties' submissions

3.9 Dealing in writing with the other parties' submissions is also something that is important to our clients. We informed the Commission at the conference that our clients were reliant on the Commission dealing with others' submissions in writing as it was important for the Commission to know this, one Commissioner having said that only our clients would have their submissions dealt with in writing.:This is particularly important for consumer interests, as they rely upon the work done by Spark, Vodafone and their experts, ultimately in relation their position as the end-users which are the focus of this pricing review.

Adequacy of reasons generally

3.10 There are a number of areas where the reasons in the drafts are insufficient or non-existent: that includes as to modelling detail as outlined above, on which we will cross-submit, when we and our clients have seen the other submissions.

The consequence of not giving adequate reasons in writing in the drafts

3.11 It is submitted that, as the drafts do not adequately give reasons as required by the Act, they are is not statutory draft determinations. This cannot be fixed by giving adequate reasons in the final determinations - that is too late, for the reasons we have given. This can only be remedied by producing properly formulated draft determinations. In turn, absence of statutory draft determinations mean that purported final determinations would not be lawful either and the Commission would need to start over with statutory draft determinations.

3.12 The drafts note, and this was also noted at the launch of the drafts, that options are open as to further drafts, a conference, etc. If it assists we are happy to discuss options that would also help allay our clients' concerns.

4. Section 18

4.1 On this important topic, the absence of dealing with submissions in writing is particularly problematic. We continue to rely on all our submissions from and including our 20 February submission.

4.2 We will not repeat the analysis in light of that but, instead, state some conclusions.

4.3 The starting point, largely recognised by the Commission, is that the TSLRIC model, under the Act, "…is itself designed to implement the [s 18] statutory purpose, not to contradict or undermine it".[5]

4.4 The TSLRIC model under the Act is all about deriving the TSLRIC price which is based on the least cost hypothetical network, also described as an efficient network ("efficient" meaning, in effect, least cost, and to be carefully distinguished from "efficiencies"). Section 18 is all about a different question: it is about efficiencies (in the dynamic and static sense), of which the "efficient" price of the service is only one factor.

4.5 However, the Court of Appeal makes clear, as above, that determining the price based on the least cost efficient hypothetical network "implements the requirements of the statutory purpose". Putting that another way, considerable care is needed before there is any departure from an approach that derives price from the least cost efficient hypothetical network. That would be inconsistent with the Act.

4.6 Thi means that applying s 18 efficiencies (such as investment incentives), to take steps that impact the TSLRIC price, adjusts the price away from the price of a least cost efficient network. Thus, the application of s 18 in the TSLRIC must be carefully managed, so that the price based on a least cost efficient network is not distorted. This is best achieved by carefully separating the decision stages, as we outline below.

4.7 TSLRIC modelling has uncertainties and, therefore, the Commission developed its plausible range concept. That is a range within which the price may still represent a reasonable estimate of the price based on a least cost efficient network. The Commission points out that there can be some challenges in determining that plausible range. But a range can be determined. We agree with the Commission's high level framework on this at Para 167 of the UCLL draft decision. We support the plausible range approach and recognise that adjustments to price via s 18 (to reflect efficiencies) can be made within that range.

4.8 This is best seen as a three-step process:

(a) First, the Commission undertakes the TSLRIC modelling, making all choices between options based solely on deriving the price based on the least cost efficient network.

(b) Second, if, during that process, there are any modelling choices where two or more options would meet that least cost approach, the Commission can use s 18 to assist in the choice between the two. This is a real world analysis, in stark contrast with the prior step which is a hypothetical analysis. That real world analysis requires consideration of the evidence and also a quantified analysis.

(c) Having derived from this what is currently called (unhelpfully, we submit) a central estimate, there might be a wash up s 18 analysis, again evidence and quantitatively based. We say "might" as this is only called for if there is a plausible range within which to choose. If s 18 adjustments have been made, there needs to be careful handling to avoid double counting. There may need to be adjustments to off-set the combined effects of s 18

[5] Chorus v Commerce Commission [2014] NZCA 440 at [153], cited at Para 149 in Commerce Commission, Further draft pricing review determination for Chorus' UCLL service, 2 July 2015.

changes during the modelling (currently that means downward adjustments, as all changes thus far are upwards).

4.9 In practice, the Commission in these drafts is conflating the first two steps. (We note that the TSLRIC and WACC uplift analysis is at the third step.) A number of modelling choices rely upon s 18 adjustment but only on a briefly stated and broadly supported basis, without reliance on evidence and quantified analysis. The drafts roll s 18 considerations into least cost considerations to produce an outcome based on only broadly stated reasons. The Commission continues to rely throughout the drafts on briefly stated economists' epithets,[6] without evidential and quantitative support, despite multiple submissions that this is not permitted by the IM judgment and other authority, and that evidence and quantification is required (again, as authority requires).

4.10 This leads to absence of analysis as to which modelling choice will produce the price based on the lowest cost efficient network, and it leads to quick and briefly stated recourse to s 18 to help determine matters. We submit that the first two steps above should be carefully delineated and the second step supported by evidence and quantified analysis.

4.11 We set out again what the High Court had to say in the IM judgment about the approach which the Commission is still largely adopting throughout the draft determinations (where the WACC uplift analysis and, to a lesser extent, the TSLRIC uplift analysis is a notable transition away from that). For example, in the first passage below, the Commission is continuing precisely down the same path in its July UCLL draft (at Para 146), contrary to what the IM judgment decides :[7]

> 6.2 For example, the draft UCLL determination states, without evidence, explanation, or engaging with submissions on the point:[8]
>
> > "Where there is a trade-off between static and dynamic efficiencies, we generally give greater weight to dynamic efficiencies. This is because of the emphasis in section 18(1) of promoting competition over the long-term."
>
> 6.3 When the High Court (comprising a judge and two highly experienced economists) firmly criticised the Commission for doing exactly that: [9]
>
> > "No supporting analysis was provided by the Commission. Indeed, the propositions advanced for choosing a point higher than the mid-point seemed to be considered almost axiomatic. This extended to a strongly expressed, but unsupported, view of the benefits of dynamic efficiencies deriving from investment, without apparent regard to the nature of the investment."

[6] See for example in the UCLL draft determination, where no evidence in support is provided: "Where there is a trade-off between static and dynamic efficiencies, we generally give greater weight to dynamic efficiencies" (para 146) Kos J simply noted that cannot be legal authority in support and the IM judgment is explicit that such statements cannot be relied upon. "A determination that undermines incentives to invest would deter future investment and so would likely undermine competition over the long-term". This sort of approach continues throughout the drafts.

[77] Wigley & Company submission 20 February 2015 at Para 6

[8] At [174]. For some reason it is noted that Kos J has noted that approach. That seems immaterial but in any event an FPP has much higher evidential and analytical requirements. That is the very nature of the difference between the FPP and the IPP.

[9] Wellington International Airport and others v Commerce Commission [2013] NZHC 3289, paragraph [1462].

And the same Court bench of three said this (being equally critical of such approaches by the Commission):

> "Where a proposition is simply asserted by economic experts, we give it little or no weight."[10]

Then, to similar effect from the same IM judgment:

> "… the Commission did remarkably little … to justify its assertions about the relative costs of over and underestimating the cost of capital …"[11]

"… we have some sympathy with MEUG's submission that the Commission's approach to the asymmetric costs of over and underestimating the WACC lacks a solid basis."[12]

4.12 The broad approach to s 18 continues down that path, contravening the IM judgment (but the separately treated WACC and TSLRIC uplift analyses represent greater compliance, as we outline below).

4.13 In the drafts, modelling choices based on s 18 have considerable impact on the "central estimate". This is not at all a central estimate of the price for the least cost efficient network, and already includes substantial uplifts based on s 18. However, the third step proceeds as though this is an unbiased central estimate of true TSLRIC cost. The analysis is as to whether that so called central estimate should be uplifted, without regard to double ups, etc. It is submitted that the third step calls for careful evidence- based and quantified analysis, to include analysis of downward adjustments required due to uplifts (for, thus far, they are always uplifts) made in the second phase. It will help not to use the phrase, central estimate, where that estimate contains s 18 based uplifts (due to, for example, a choice between two options).

4.14 We now deal with the evidence and quantified analysis aspects as to s 18, in the next two sections.

5. WACC and TSLRIC Uplifts

5.1 Welcomed is the Commission's approach on the WACC percentile issue, including to obtain quantified evidence and a CBA, and to have OXERA replicate the work they did on the Part 4 WACC percentile review. While we have reservations as to aspects, this has confirmed that the WACC percentile should be set no higher than mid-point.

5.2 Also welcomed (again with reservations) is that there is to be no uplift to the TSLRIC price, based on overlapping analysis, and a reworking of the 2 April calculation of net benefits and detriments.

5.3 We will deal first with the WACC uplift work and then outline our reservations;

[10] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1745].

[11] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1440].

[12] Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013], paragraph [1470].

WACC uplift

5.4 We especially welcome the increased use of the quantitative approach reflected in the Oxera material as peer reviewed by Professor Vogelsang.

5.5 We welcome developments, such as:

(a) The WACC percentile analysis does not just rely on qualitative analysis and judgment.

(b) It makes a genuine attempt to quantify the costs and benefits, to the extent practicable. This is not to say it is perfect (and for example it does not reflect yet our 11 May submissions). It is submitted that it overstates the benefits of uplift, though this does not impact on the ultimate result of the analysis against uplift. (Given however the draft decision is to have no uplift, we will not submit in detail until cross-submissions, particularly so that submissions can be made to deal with points that may be made by Chorus.)

(c) The analysis and evidence is supported by way of expert peer review (Vogelsang etc.).

(d) The analysis and evidence addresses a number of the concerns raised by the High Court about the Commission's original Part 4 WACC percentile decision.

(e) The Commission has applied an approach to evaluating the optimal WACC percentile which is consistent with that applied to the Part 4 WACC percentile review last year.

5.6 We therefore welcome this development.

Reservations

5.7 Our first reservation is that outlined at the start of this submission: the Commission has not dealt with or dealt with adequately, as the documents show, our 11 May submission, which is relevant to both WACC and TSLRIC uplifts. We can submit when that happens.

5.8 Second, all our submissions from and including our 20 February 2015 submission, up to the 11 May submission, deal extensively with quantitative analysis issues. Most points have not been addressed in writing, as is required nor do the matters raised generally appear to be reflected in what has happened.

5.9 In any event, it is quite apparent that fairly straightforward problems with the 2 April model (that is the TSLRIC model not the Oxera work) have not been rectified in the new version, and the Commission does not deal with specially identified items. In this regard our relevant submissions from and including our 20 February 2015 up to our 11 May submission remain "live".

5.10 Thirdly, in continuance of the apparent assumption that this issue is solely about uplift for both TSLRIC and WACC, the net welfare position is not calculated as to what happens if the TSLRIC or WACC is adjusted down not up.

5.11 The Commission explained why a downward price movement has not been explicitly modelled as follows:

> We have not explicitly modelled a move below our central TSLRIC estimate or WACC mid-point, as we continue to be of the view that in the current case, setting a regulated price below what we expect to be the TSLRIC of supplying the UCLL service is unlikely to best give effect to the section 18 purpose statement of the Act. This is because setting such a regulated price will not by definition allow for the recovery of the efficient forward-looking costs of supplying the UCLL service, and is therefore, likely to send a strong negative signal for investment in new network infrastructure in the future. In addition, setting a regulated price that is below our central estimate is likely to distort demand and slow migration to fibre. [13]

5.12 It is submitted that this is not the correct approach for the following reasons:

(a) Just as a quantified analysis has to be done for an uplift analysis, so too must it be done for the effects of a downward movement in TSLRIC and WACC. The reasons are the same, including the legal requirement to do so, as outlined in earlier submissions.

(b) This will have the benefit of avoiding an impressionistic approach, which is what is happening in the paragraph quoted above, given also the IM judgment counsels against such an approach.

(c) In the paragraph quoted above, the Commission contradicts its approach on the uplift, by seemingly assuming that there is a single true TSLRIC price (namely, the "central estimate") and that means:

(i) "by definition", the efficient forward looking costs will not be recovered; and

(ii) there will be negative investment signals as to investment in new infrastructure in the future.

(d) As early as the paragraph immediately following the above quoted paragraph, the Commission reconfirms that such an approach is, in the Commission's own words, "misconceived":

> The final output of the model represents our central estimate of the forward-looking TSLRIC for the UCLL service. In other words, the final output reflects the various modelling choices, many of which have a range of reasonable options. For this reason, we consider that there is more than a single reasonable TSLRIC for the UCLL service. Any assertion that a TSLRIC modelling exercise automatically produces the "true TSLRIC" is misconceived. Accordingly, in the present context, we consider our TSLRIC output as a central estimate that lies within a "plausible range".

(e) If there is room to move up, relative to the central estimate – clearly the Commission accepts there can be that movement – there must be room to

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move down within a plausible range. But the Commission has always thought of this issue in terms of up not down movement.

(f) It therefore does not follow that a downward movement means efficient costs will not be recovered. Nor does it mean that negative signals will be sent to investors as to new network infrastructure. On that last point, we went into some detail as to why that is not so, but our submissions have not been read and/or dealt with: part of our submissions were that where the regulated pricing of copper lands has little or nothing to do with the separate question of pricing, setting WACC, etc., as to other infrastructure (and this can readily be managed by the Commission).

But, like the Commission's approach, that is qualitative if not impressionistic. It is the quantitative analysis that must be done on downward movement as well as uplift to get the answer.

(g) We reiterate – consistent with the High Court's commentary on RAB in the IMs Merit Appeal – that to reach a conclusion that a price is too low (including a price that adopts a below mid-point WACC) and would undermine incentives to invest it would need to be demonstrated that it would preclude Chorus' from recovering its prudent and efficient investment in copper (UBA and UCLL services). This is a point we have made multiple times and Chorus' is yet to provide any evidence it would be financially impaired by the Commission's draft prices (or lower).

(h) It is helpful to stand back. In the apparent drive for prices to be increased, it seems little regard is had as to the real world in which Chorus operates, implying that there should readily be a downward price movement. For example:

(i) As the Commission notes, "the asset values for UCLL and UBA used in our further draft determinations total approximately $6.6 billion, which is significantly greater than Chorus' enterprise value (ie, the value placed by the market on all of Chorus' business activities). Chorus' total enterprise value (including services not covered by UCLL/UBA regulation, such as UFB) is approximately $3.3 billion".[14]

(ii) The Commission has noted use of historic cost, rather than ORC, for re-useable assets would reduce the draft UCLL price by 9%.[15]

(iii) And Professor Vogelsang, "… the conservative approach taken by the Commission is generous relative to an alternative standard, under which prices would result that reflect re-use of equipment and would reflect performance adjustments."[16]

(iv) Chorus obtains a large head start by reason of the de-averaging of the prices, as the Commission notes in its draft determinations.

(v) It is well known to regulators and economists that TSLRIC over-compensates the operator of a sunset copper network: that is why, as again is well known, there is such a departure from using

[14] Commerce Commission, Cost of capital for the UCLL and UBA pricing reviews, 2 July 2015, paragraph 313.2.
[15] Commerce Commission, Cost of capital for the UCLL and UBA pricing reviews, 2 July 2015, paragraph 313.1.
[16] Ingo Vogelsang "Reply to Comments on my November 25, 2014, paper "Current academic thinking about how best to implement TSLRIC in pricing telecommunications network services and the implications for pricing UCLL in New Zealand" 23 June 2015, paragraph 24.

TSLRIC, using for example building blocks etc. In the real world, this collection of decisions driving the price north is contrary to that reality.

(i) As we have submitted above – but the Commission has not responded to – the s 18 analysis is a real world, fact based analysis. That is distinct from the prior step: the TSLRIC analysis which is deliberately hypothetical. Concepts such as a price high enough to ensure "the recovery of the efficient forward-looking costs" have no place in the s 18 analysis, as that is a real world analysis.

(j) Finally, we note the submission above, when dealing with s 18, that the quantified analysis for the TSLRIC price movement should take into account, quantitatively, any off-setting change (currently, downwards) to reflect increases in the "central estimate" due to uplifts resulting from applying s 18 (eg due to choice of one modelling option over another).

6. WACC and TSLRIC uplift analysis: implications

6.1 The analyses, showing there is no justification for WACC or TSLRIC uplift, apply also to other s 18 questions relating to price (with an overlapping but different treatment for relativity which is treated separately in the Act and dealt with later in this submission).

6.2 The evidential standard the Commission has applied to the question of the optimal WACC percentile is substantially higher than it has applied to other aspects of its revised drafts, including other matters that are likely to have a larger impact on the pricing determinations. In this section we submit that the same level of quantitative analysis is required, and that most of the answers lie already in the WACC and TSLRIC uplift analysis.

6.3 The WACC uplift and the TSLRIC uplift assessments ultimately boil down to one thing: should the monthly price go up, down or stay the same, to meet s 18 objectives (namely, promoting competition in the LTBEU)?

6.4 Those assessments are the best evidence of this and they are quantitative (although they need improvements especially the TSLRIC assessment).

6.5 Outside the WACC and TSLRIC uplift questions, the draft determinations base decisions on a number of modelling choices upon s 18. But this is done qualitatively and only briefly explained, if explained at all. This is happening in choices between modelling options.

6.6 We note, in passing, the important point that the Commission is still making s 18 adjustments (which impact the price) in modelling choices which feed into central estimate, despite noting this does not and should not happen. The central estimate is therefore pre-loaded with decisions based on s 18, involving substantial impacts on the ultimate UCLL and UBA prices.

6.7 For example:

(a) The decision to go with forward looking costs, and not historical costs, for reusable assets is based on s 18 (the Commission has calculated the difference at around $2.50).

(b) Likewise as to the copper v fibre/FWA MEA choice.

6.8 In all cases it is submitted that these choices must be made based on sufficient quantitative and evidence based analysis.

6.9 Fortunately, this is now readily available. As the intended and actual effect of a choice between approaches is to impact price, up, down, or neutrally, the Oxera and other quantitative analysis, as it stands at present, confirms that the decision is not to choose the approach that produces the higher price.

6.10 It does not matter whether the price uplift would arise from setting WACC above mid-point, use of scorched node rather than scorched earth (and any other judgment about the appropriate level of optimisation), choice of MEA (including FWA), use of ORC or historic cost to value re-usable assets, backdating or any other decision impacting on price. An uplift is an uplift is an uplift.

6.11 This is a point Wigley and Company and CEG have both made previously. We said "The arguments against setting WACC above mid-point apply equally against any other TSLRIC modelling decisions that would result in an uplift".[17]

6.12 CEG have noted "Where we refer to a cost of capital uplift … we could equivalently express this as a price uplift".[18]

6.13 The Commission's calculation of the price impact of use of ORC rather than historic cost for re-usable assets does show that it can quantify the impact of uplifts from generosities other than WACC. The Commission has done some of the quantified analysis required on these issues – specifically, that use of ORC for re-usable assets results in a UCLL price of $26.31 rather than $23.84 (which equates to end-users paying over $350 million NPV more than they otherwise should) – but has not taken this into account in any form of CBA assessment. It is submitted this needs to be rectified as to these choices between modelling options.

7. Relativity

7.1 When the Commission dealt with relativity generally, as between UCLL and UBA, it concluded against promoting unbundling (and, effectively, against unbundlers). It said:

> Relativity guides us less towards attempting to promote unbundling, and more towards the efficiency aspects of the section 18 purpose statement which we consider are likely to have a larger effect on the promotion of competition for the LTBEU. We consider that we should be neutral towards the promotion of unbundling, and allow for unbundling to occur to the extent it is efficient.[19]

7.2 Relativity is also an issue for which quantitative analysis is relevant, and required. It has not been done. Like the other s 18 issues dealt with above, quantified analysis is required, on this issue which has very large dollar implications. As above, the Commission has the framework via the Oxera, etc modelling. However, as is also the position for the WACC and TSLRIC uplift analysis, this raises issues to be resolved around what is promoted and how it is promoted.

[17] Wigley and Company, Submission on draft pricing review determination for UBA and UCLL services, 20 February 2015, paragraph 10.1
[18] CEG, Welfare effects of UCLL and UBA uplift, March 2015, paragraph 45.
[19] Commerce Commission, Further draft pricing review determination for Chorus' UCLL service, 2 July 2015, paragraph 541. There is some further detail in the Cost of Capital paper at Para 316-319

7.3 In coming to its draft view, the Commission does not explain why the prior decisions to the contrary by two of the three current Commissioners are not being followed. Similarly as to what the prior Telecommunications Commissioner stated before he started representing Chorus.

7.4 Nor does the Commission deal with the comprehensive analysis as to relativity over a number of pages in our 11 May 2015 submission. including as to what the Commissioners said. That 11 May submission is the subject of the case study at the start of this submission.

7.5 We provided that submission on behalf of the largest unbundler. Relativity is a major issue for them, of course, and it is a matter with the issues and complexities outlined in our 11 May submissions.

7.6 Yet the submissions appear not to have been read and considered given (a) what is in the case study above and (b) the limited nature of the discussion on relativity in the UCLL draft determination without regard to the matters raised.[20]

7.7 This places our clients in a difficult position which was readily avoidable had the Commission done what was required of it.

7.8 This is another manifestation of the lack of ensuring that all material submissions are dealt with in writing. It is submitted that the Commission must issue a compliant draft determination, to enable our clients to submit adequately. For completeness it relies on all of its relativity submissions in the meantime.

8. UCLL aggregation model

8.1 The Commission has not dealt in writing with our submissions criticising the aggregation model.[21]

9. Investor expectations, predictability and now "conventional"

9.1 We were initially pleased the Commission acknowledged it had put too much weight on achieving "predictability" it the December draft decisions.[22] We would welcome the Commission adopting an approach whereby it does not seek "to re-interpret section 18 or apply it in a different way" and regulatory predictability is treated as "a relevant consideration in the broad sense of best regulatory practice".[23]

9.2 However, unfortunately, there is no evidence the apparent change in position has had any impact on the July revised drafts.

9.3 In substance, the July revised drafts are based on the Commission's interpretation of predictability just as much as the December drafts.

9.4 There is still the same emphasis on adopting a conventional or orthodox approach to implementing the concept of TSLRIC, which the Commission has interpreted as predictable.

[20] At 524-541
[21] Wigley & Company submissions 20 March 2015 at Para 13. There is passing, but not substantive reference to one facet of this submission at Para 426 of the 2 July 2015 Draft UCLL determination
[22] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 139.
[23] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 138.

9.5 The only change we could find is that the Commission has increased in references to adopting a "conventional" approach, which the Commission considers "helps promote regulatory predictability" anyway, and made less references to adopting a "predictable" approach.

9.6 The July UCLL draft alone makes 34 references to adopting a "conventional" or "orthodox" approach (compared to 26 references in the December UCLL draft),[24] and still makes 41 references to adopting a "predictable" approach (down from 70 in the December UCLL draft).

9.7 What we seem to be seeing is simply a shift in language – form over substance.

9.8 The Commission referred to how respecting reasonable investor expectations would promote predictability, early in the FPP determination process, then it focussed on predictability in the December drafts, and now the focus seems to be split between what is conventional (and is supposed to promote predictability) and predictable. The outcomes are still the same e.g.:

> In our view, a modified scorched node approach therefore better aligns with our TSLRIC objective of predictability, including the fact that it is an orthodox approach.[25]
>
> A tilted annuity methodology is the orthodox depreciation methodology used in electronic communications regulation, and we have previously adopted a tilted annuity methodology in the TSLRIC context. In our view this approach is therefore most consistent with our TSLRIC objective of predictability.[26]
>
> European Commission "move away" from the conventional approach to TSLRIC … We have noted that the implementation of TSLRIC using a hypothetical operator building an entirely new network with modern assets is the conventional approach. More recently, however, the application of TSLRIC by some regulators have moved away from that approach, with the European Commission (EC) recommending a methodology to be applied by European regulators which "should not assume the construction of an entirely new civil infrastructure network for deploying an NGA [next generation access] network".[27]
>
> Our view remains that the MEA is FTTH/FWA. It is, in our view, clearly what a hypothetical efficient operator would deploy now to provide the "core functionality" that we discuss above. TERA's advice is that conventional TSLRIC practice is to adopt a single MEA.[28]
>
> ORC is consistent with our previous approach to TSLRIC and therefore our TSLRIC objective of predictability.[29]
>
> A capacity-based allocation is often used in TSLRIC models, and therefore we considered it to be consistent with the objective in our December 2014 UCLL draft determination paper of giving greater weight to predictability of approach.[30]

[24] The references to orthodox actually declined.
[25] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 1047.2.
[26] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 1401.1.
[27] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 193.
[28] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 1032.
[29] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 1209.2.
[30] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 1710.1.

> We noted that EPMU was a widely used methodology (which we considered was consistent with the objective in our December 2014 UCLL draft determination paper of predictability) … While we no longer place significant weight on an objective of predictability, we still think it is relevant to consider how regulators elsewhere implement TSLRIC models.[31]
>
> While we no longer place significant weight on an objective of predictability, we still think it is relevant to consider how regulators elsewhere implement TSLRIC models.[32]

9.9 We turn now to one facet of this problem: reusable ducts.

10. Reusable ducts

10.1 On this issue, the Commission has not dealt with most of our submissions in writing, as it is required to do.[33] We can submit on a compliant statutory draft determination, when that is provided.

10.2 However, we wish to identify a threshold issue, and this will also assist the Commission to formulate more fully its approach. The Commission appears to seek to differentiate the TSO methodology from TSLRIC. For example it, correctly, notes that "TSLRIC" was not referred to by the Supreme Court. It also sets out a history of its involvement in TSLRIC, but makes no mention of TSLRIC's role in TSO.

10.3 However, our submissions demonstrates strongly that the Commission, when doing TSO pricing, was in fact using TSLRIC. It makes no difference that the TSLRIC name was not raised in the judgment. The TSO pricing model was in fact TSLRIC.

10.4 As the Commission noted on the last FPP in the draft determination (which is where it ended):[34]

> The TSLRIC modelling differs from that of the TSO because TSLRIC includes an allocation of common costs, such as corporate overheads, whereas the TSO calculates the incremental costs of CVNCs. In practice, this requires the TSLRIC model to include some additional costs not included in the TSO core network model

10.5 The same modelling is used, save as to allocation of common cost (which is known as the difference between TSLRIC and TSLRIC+, which is an irrelevant difference in this context). Given the timing and history, this of course means that the Commission built up its expertise, its models and so on in the TSO processes and the learnings were then applied in the FPP. TSO led the way with TSLRIC in New Zealand.

10.6 This has two implications. First it is wrong to say, as the Commission does in the UCLL draft determination,[35] that "ORC is consistent with our previous approach to TSLRIC and therefore our TSLRIC objective of predictability".

[31] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraph 1716 and 1718.
[32] Commerce Commission, Further draft pricing review determination for Chorus' unbundled copper local loop service, 2 July 2015, paragraphs 1712 and 1718.
[33] Such as our 20 February submissions at Para 13
[34] Draft Determination on the application for pricing review for designated interconnection services 11 April 2005 Para 67
[35] At para 1209

10.7 The last TSLRIC exercise by the Commission before this one ended up as historic cost. The Supreme Court said so. Historic cost for this FPP is what is predictable. Not ORC.

10.8 That is also consistent with what the Commission's adviser stated in his expert report to the Commission, although regrettably the Commission has omitted this highly relevant passage from its draft. But we have it in our submission (not dealt with of course in the draft determination despite its clear relevance). Professor Vogelsang said (highlighting added):[36]

> "Rather than starting from scratch the re-use of those civil works facilities for the new set of cables is usually the most efficient way to go forward. It also reduces the probability the regulated firm is over-collecting" and "**a historic cost approach is generally….more predictable than a replacement cost approach**."

10.9 What could be clearer?

10.10 To the second point. The Commission seeks to interpret the TSO judgment as though TSLRIC is not at all involved. The fact is that the Commission was doing a TSLRIC pricing. It should revisit the interpretation, to take into account that fact.

10.11 Whatever the legal position, this has, like the contortions to have a strange copper UBA MEA, the signs of splitting hairs and gymnastics, to also derive a higher price, rather than dealing with the real substance, and also the reality that Chorus is gaining far more than it should, as the Commission's expert has shown.

11. Infrastructure sharing

11.1 From and including 2014, we have submitted that there is an artificial limitation of infrastructure sharing to third parties such as electricity utilities. However, the purpose of TSLRIC is always expressed to be one of deriving the price from the least cost hypothetical network, assuming the copper network is not there.

11.2 The counterfactual is recognised as leaving in place things such as the existing terrain and access to existing power poles. But what the Commission is not doing is to include the other elements that still exist assuming the copper network is removed. In particular, that includes the UFB networks over which space can be leased in the case of LFCs or cost –apportioned, in the case of Chorus' fibre network.

11.3 The Commission has not dealt in writing with this and other infrastructure sharing submissions.

12. FWA

12.1 The Commission continues to use the legacy network to determine the FWA footprint, when this is to be a green fields analysis. It does not meet the "new technologies" requirements in the TSO litigation. More broadly, we will cross submit after review of other submissions including those of experts.

[36] Quoted at 14.2 in Wigley & Company Submission dated 20 March 2015 Para 14

13. UCLL footprint

13.1 The Commission has not dealt in writing with our 20 March submission at Para 13.21- 13.24.

14. GPON not P2P

14.1 The draft does not address the submission that the MEA is PON not Point to Point.[37] It takes the approach of assuming Point to Point.

15. UCLFS

15.1 The Commission has not dealt in writing with our 20 March submission at Para 13.25.

16. UBA MEA should be fibre and FWA

16.1 The Commission permitted a long standing and straightforward error which was notified to the Commission soon after it happened (that the MEA could only be copper) to remain uncorrected until as late as July 2015. It did its calculations in its December draft based on a highly unusual basis: a fibre/FWA MEA for UCLL and a copper MEA for UBA. A combination that is far from realistic even in the hypothetical world of TSLRIC.

16.2 It is not accepted that a copper MEA produces a similar price to a fibre/FWA MEA. That is contrary by a large margin to even TERA's own views, as we have submitted. Notably, the Commission goes to some lengths to put forward a strained copper MEA theory, when, if its conclusions are right and the costs are the same, it could take the simple course.

16.3 In July, by circuitous and unusual steps, the Commission opts for a copper MEA, and that continues the copper MEA path.

16.4 It seems that no matter what consumers and the RSPs say, the prices for the two services and the underlying solutions will remain the same. As one unusual ground is shown to be wrong it is cookie-cutter replaced by another unusual ground. A number of submitters have observed this happening over the course of this FPP and this appears to be another iteration, along with other aspects raised in this submission. It is hard to understand why this pattern is happening and how it can be justified although the undue haste to which we have referred before may in part contribute to this.

16.5 What is apparent is that the Commission is conflating its role (contrary to submission and contrary to its own position) as to (a) what is required by TSLRIC and (b) what is required/allowed by s 18..

16.6 In addition to the problems noted above, the Commission only refers to a cost comparison between a fibre/FWA MEA and a copper MEA but has not provided the detail in order to enable the parties to check this. Given TSLRIC is fundamentally about least cost networks, and, as we have submitted earlier, choice of MEA requires comparison of the relative costs of each MEA, this comparison is crucial to the decision and crucial to enable submissions to be made.

16.7 Further to the point, in responding to the Spark submission which compared New Zealand broadband pricing with overseas pricing the Commission and

[37] Wigley & Company Submission dated 20 March 2015 Para 14

TERA have gone to great lengths to point out that the significant differences in pricing are due to trenching or other copper deployment costs in rural areas. If a full analysis of alternative MEAs had been undertaken at the beginning of the FPP process as recommended this information would have been available much sooner and would have then been available to inform the choice of the best (lowest cost) MEA to apply in any given area.

16.8 But the comparison has not been provided. It's not to be found on review of the Tera's model documentation (reference, specification, documentation) and Commission material (Annex B of the UBA draft determination). There only seems to be a rough description in paras 767 and 769 in the UBA draft determination and footnote 318 which talks about a switch in the UBA (Excel) model.

16.9 We cannot meaningfully submit until that modelling is provided by the Commission, and that still leaves the problems with lack of dealing with submissions and lack of a compliant draft determination, dealing with all material submissions.

17. UBA footprint

17.1 There have been a number of submissions on this, which have not been dealt with in the drafts.

18. EUBA pricing

18.1 Our clients have specifically requested that we seek appropriate price treatment of the EUBA variants. Those services are often not taken up by RSPs due to their pricing. Low usage now of EUBA variants does not mean that pricing these services is an academic exercise. Properly priced there will be uptake.

18.2 We can add little to our submission already[38] and we rely upon it. Simply put, the pricing of each EUBA variant is not compliant with the Act, as it is not determined upon cost: there are additional non-TSLRIC cost factors added that are not permitted by the Act. It is not enough to describe the approach as acceptable as the prices are "cost oriented."[39] Each of the services in the STD is to be priced separately, based on the cost of providing that service (via the HEO). Each service's components can readily be identified, just as, say, BUBA's components can be separately identified from non-regulated services over the same path.

19. Non-recurring charges

19.1 From our perspective, submissions are more sensibly done in cross, after reviewing expert and other reports. A specific issue however. Retention of the current POA structure is problematic and it should be changed, with some form of clear metric which is directly cost-based, or enables a cost-based price to be fixed quickly (eg by expert determination). Currently, a central feature is that Chorus gets two competitive quotes. Most suppliers, already supplying to Chorus, have no incentive to lowest cost quote: nor does Chorus have that incentive. The current approach is unworkable.

[38] Wigley & Company submission 20 March 2015 at Para 15
[39] UBA draft determination 2 July 2015 Para 386