Retroactive rate setting
A review of regulatory precedent

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1 Findings of our study

This report provides an international perspective on retroactive re-determination of regulated rates. This review has been conducted in the context of a recent decision by the Canadian Radio-television and Telecommunications Commission (CRTC) to retroactively apply its final determination on varied wholesale high-speed access (HSA) rates. We have reviewed precedent from the UK, Australia and New Zealand as developed economies with similar legal traditions which utilise cost-based, industry-wide rate setting frameworks in their telecommunications sectors, similar to Canada.

Our key findings from this review are as follows:

(a) The CRTC’s decision is out of step with international best practice. In our view, the CRTC’s decision would not (or could not) be replicated in our comparison jurisdictions. While the regulators in these jurisdictions do have the power to re-open and vary previous rate determinations, either:

- the regulator is prohibited from applying any variations retroactively. Consequently, the situation that has arisen in Canada simply could not arise in these other jurisdictions. This is the situation in the UK; or
- to the extent that the regulator has a legal power to retroactively apply variations, their consistent practice is not to do so. This is the position in Australia and New Zealand.

(b) The rule or practice against retroactive application of variations of final determinations is driven by the following policy considerations:

- regulators cannot alter past behaviour by retroactive application of a rate determination. The results of retroactive application of varied rates are either a distortion of future competition and/or a wealth transfer between shareholders of the access provider and the access seekers; and
- retroactive application of rate determinations sits uncomfortably with the core principles of ex ante regulatory frameworks, which are designed to create conditions for efficient future behaviour, including efficient investment, operation and use of critical infrastructure, by setting future rates to align with expected future efficient costs. The spectre of retroactive rate setting can create considerable uncertainty for access providers and access seekers, potentially undermining incentives for future investment. This investment uncertainty swings in both directions – while, in this case, the CRTC’s retroactive rate settings benefits access seekers, the NZ regulator has rejected the retroactive application of higher access charges because of the adverse impacts on investment decisions of access seekers.

(c) The unusual nature of the CRTC’s decision to retroactively apply the varied rates is compounded by the comparatively low threshold for the CRTC’s decision to re-open its original decision and consider a variation in the first place. To provide more investment certainty, other ex ante frameworks place restrictions on the regulator’s ability to reopen and vary rate determinations. In some cases, the rules may preclude a re-opening except in cases of manifest error, miscalculation, reliance on false or misleading information, or a breach of legal requirements. In other cases, the regulator may be prevented from re-opening its determination unless it is satisfied that there has been a material change in circumstances. Restrictions on re-opening determinations apply in New Zealand and the UK.

(d) It is for these reasons that the compared jurisdictions have safeguards described above which would preclude their regulators making the same kind of decision which the CRTC has made in the HSA case.
2 Background and approach

2.1 The CRTC decision

The CRTC’s recent decision on HSA rates follows from a review of costing inputs which was initiated in 2015. The review related to costing assumptions underpinning the rates that were approved for HSA services in an earlier decision of the CRTC (a decision that was originally made in 2011, and subsequently varied in 2013). The CRTC made an interim decision on its review in March 2016 and a final determination in August 2019. The CRTC decided that the rates determined under its final decision were to apply retroactively from the date of its interim decision (i.e. from March 2016).¹

There are two aspects of the CRTC decision that are particularly striking:

· first, rates have been determined retroactively over a long period – more than three years – and with significant adjustments made to the rates set in the interim decision. The consequence is that a very large adjustment payment will need to be made for the period of retroactivity; and

· secondly, the decision has been made in the context of a review of a previous determination on costing methodologies. In this previous determination, originally made in November 2011, the CRTC had approved rates based on a ten-year cost study (the rates approved in 2011 were subsequently revised in 2013, mostly to account for costing errors). The review which was initiated in 2015 was effectively a reopening of the long-term costing assumptions underpinning this earlier approval.

The CRTC decision to retroactively reset rates raises two important questions of regulatory design:

1 whether and in what circumstances it is appropriate to reopen past rate determinations; and

2 whether and in what circumstances it is appropriate to retroactively reset rates.

These two questions are clearly interrelated. The circumstances in which a determination is reopened are likely to be relevant to a decision on whether a reset of rates should be done retroactively or only prospectively.

Our review of regulatory precedent therefore addresses these two issues together. We consider both the ability of regulators to reopen past determinations, and their ability to retroactively modify these past determinations.

2.2 Our approach to this review

This report provides brief an international perspective on the two design issues set out above.

In comparing the position in Canada with other jurisdictions, it is important to account for differences in rate determination frameworks. Canada has an ex ante determination framework for setting access rates. Under the existing regime, the CRTC determines what services are to be regulated, and then requires service providers to file proposed tariffs and cost studies to support the rates in those tariffs. The cost studies are based on

CRTC approved costing manuals that use a form of Total Service Long Run Incremental Costs (TSLRIC) called Phase II.

The alternative approach to setting access charges is called the negotiate / arbitrate model. Under negotiate / arbitrate model, a regulator will only be asked, as a ‘back stop’, to resolve specific disputes over access charges if negotiations between an access seeker and an access provider fail. For this reason, the conditions under which regulatory determinations are applied retroactively in an ex post regime do not provide a relevant comparator for the CRTC’s HSA proceedings. Therefore, we selected the UK, Australia and New Zealand as comparators, because ex ante determination frameworks apply to at least some telecommunications network access services in these jurisdictions.

3 United Kingdom

In the UK, Ofcom may vary or revoke its determination of ‘SMP conditions’ (which may include rates) for a communications provider with significant market power. The Communications Act 2003 expressly provides that the power to make a SMP condition includes “power revoke or modify the conditions for the time being in force”. However Ofcom may only vary SMP conditions (including rates) where there has been a material change in the relevant market or a review of the underlying market power determination. Ofcom cannot apply a variation of rates retroactively. More generally, Ofcom cannot apply an ex ante charge control with retroactive (or even retrospective) effect.

This position is well settled, following a decision of the Court of Appeal on review of a decision made by the Competition Appeal Tribunal (CAT). The CAT had decided that, in disposing of an appeal from an Ofcom price control determination relating to mobile termination rates, Ofcom could be directed to reset rates for the entire period of its original determination, including a period which had already elapsed. The Court of Appeal overturned the CAT decision, finding that any resetting of rates by Ofcom could only operate prospectively.

The Court of Appeal found that the power of Ofcom to make a rate determination in the first instance was limited to making prospective determinations. The Court of Appeal pointed to various aspects of the European Commission (EC) Framework and Access Directives and the Communications Act 2003 which supported this conclusion:

1. recitals (25) and (27) of the Framework Directive refer in terms to the need for “ex ante obligations” in order to ensure the development of a competitive market in markets where there are one or more undertakings with significant market power;
• the forward-looking nature of such obligations is also apparent from the terms of Article 13 of the Access Directive: for example, the reference to the imposition of obligations in situations where an operator "might" act in a particular way;

• in the Communications Act 2003 (which implements the relevant EC Directives), the power under section 45(1) is to set conditions binding the persons to whom they are applied, and the evident intention is to bind them in respect of their future behaviour;

• section 88 provides in subsection (1)(a) that Ofcom is not to set an SMP condition except where there is a relevant risk of adverse effects arising from price distortion, all of which is defined by subsection (3) by reference to the pricing behaviour that the dominant provider might adopt; and

• the references in subsection (1)(b) to promoting efficiency and promoting sustainable competition are likewise directed towards the future and not the past.

In relation to Ofcom’s power to vary a price determination, the Court of Appeal stated:7

…the power of modification under section 45(10)(e) is necessarily subject to the same constraints, and has to be exercised for the same purposes, as the power to set conditions in the first place. By the terms of the subsection, the power to set a condition “includes” power to modify the conditions for the time being in force. The provisions that qualify the power to set a condition therefore also qualify the power to modify conditions. If the power to set conditions is a power to set conditions with prospective and not retrospective effect, then the power to modify existing conditions is likewise a power to modify them with prospective and not retrospective effect.

Ofcom’s power to vary rate determinations is thus strictly limited to making prospective determinations.

The Court of Appeal decision recognised that while a power to vary is a necessary safeguard in an ex ante rate setting regime, if this was coupled with a power to make the variation retrospective, the rationale of ex ante regulation would be undermined.

### 4 Australia

The Australian telecommunications access regime allows the Australian Competition and Consumer Commission (ACCC) both to ‘re-open’ and vary a final determination and to backdate a final determination to the commencement date of an interim determination. However, these powers are exercised in a tightly structured framework which, consistent with the rationale of ex ante regulation, focuses on prospective rate setting.

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The Australian access regime seeks to ensure that there will always be an access determination in place for each declared service. To this end, the ACCC is required to commence the process for making an access determination:

- where a service is newly declared, within 30 days of the declaration being made; or
- if a declaration is already in force and an access determination has previously been made, at least six months prior to the expiry of the current access determination.

An interim access determination may be made in some circumstances where a final access determination has not yet been made for a declared service – for example, where a service is newly declared and the ACCC is in the process of making its first access determination for that service. In this case there is no immediately preceding access determination with which the new determination can ‘dovetail’, and so it is appropriate that an interim determination be put in place given the time required to undertake a full costs review to set the final determination. However, an interim determination cannot be made while an inquiry is underway to vary existing rates.

4.1 Scope for the ACCC to vary an access determination

The ACCC may vary an access determination. However the power to vary an access determination must be exercised in the same manner as the power to initially make the determination – this means that, in most cases, the ACCC must hold a full public inquiry before varying an access determination and must take into account the same matters as it would in making the original determination.

The ACCC could, as the CRTC has done in 2013, decide to vary the 2011 HSA determination due to calculation errors, but, as discussed below, the ACCC could not have made the interim order pending its review (i.e., the 2016 decision) and therefore would not have ordered any rates being retroactive in the 2019 decision.

The ACCC has varied access determinations in some cases following public inquiries. However such variations have generally been to the geographic scope of regulation, rather than changing regulating prices – i.e. extending regulation to areas where the access provider previously had an exemption.

4.2 Retroactive application of variations

Ordinarily, where an access determination replaces an earlier determination that is expiring, the new access determination can only take effect from the day after expiry of the old determination – this effectively prevents a new access determination from...
having retroactive effect in a period covered by a previous access determination. It is not entirely clear whether this would prevent a variation to an access determination having retroactive effect.

However, the ACCC has never applied a variation to a (final) access determination retroactively. In all cases, variations have been made with prospective effect.

Therefore, while the ACCC can vary an access determination, as the CRTC has done in the case of its HSA determination, the ACCC has never applied a variation retroactively.

4.3 Retroactive application of final access determinations which replace interim determinations

The only case in which access determinations have been applied retroactively is where an interim determination has been in place. Where an access determination replaces an interim determination that has been made for a newly declared service, the ACCC has a discretion to apply the final determination retroactively back to the date on which the declaration came into force.14

However, this does not provide a precedent for the CRTC’s approach in the HSA case. Quite the opposite - the Australian framework explicitly does not allow an interim determination to be made while a process for variation of an existing determination is in train.15 The original order stands pending the decision on the variation. Thus, the issue around retroactive application simply could not have arisen in Australia in the same way as it has in Canada.

As noted above, the policy rationale for retroactive application of final determinations to replace interim determinations is very different in an ex post (negotiate/arbitrate) regulatory regime compared to an ex ante regime, such as applies in Canada and the countries in this study. This is illustrated with the shift in the Australian telecommunications regulatory framework from ex post to ex ante access regulation in 2011.

Under the previous ex post regime, if commercial negotiations broke down between an individual access seeker and an access provider and the regulator was called upon to resolve the dispute, the regulator had broad power to retroactively apply final determinations (often back to the commencement of negotiations). However, the new ex ante regulatory regime sets out a tightly structured set of rules around the making and variation of access determinations. Access prices are now set prospectively on an industry-wide basis; access determinations are generally intended to run their full term and to succeed each other in a linear way; there is a degree of flexibility to vary an access determination during its term but the established practice is to only do so prospectively; and the power to make interim orders lapses once the first rate determination in the chain is made.

The ex ante regime introduced in 2011 was, amongst other policy rationales, purpose-built to avoid the uncertainty arising under the former ex post determination regime, in which rate determinations could be (and often were) applied retroactively.

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14 Competition and Consumer Act 2010 (Cth), s 152BCF(4A).
15 Competition and Consumer Act 2010 (Cth), s 152BCG. The circumstances in which the ACCC may make an interim determination are strictly limited to where there is a new declaration (not replacing a previous declaration) or there is otherwise no access determination already in force. The ACCC must not make an interim determination in any other circumstances.
5 New Zealand

In New Zealand, there is a two-stage process for setting rates. The New Zealand Commerce Commission (NZCC) first makes a ‘standard terms determination’ (STD), which is based on an initial pricing principle (IPP). Once the STD is made, any party may then seek a ‘pricing review determination’, applying the relevant final pricing principle (FPP). The STD is effectively an interim determination, subject to a pricing review determination in accordance with the applicable FPP.

Once a pricing review determination has been made, it can only reopened and varied if there has been a material change of circumstances or if the determination was made on the basis of information that was false or misleading in a material particular.16

There is a legal power to backdate rate determinations, including to cover the period of an interim determination. However the NZCC has exercised great caution in exercising this power. In recent pricing review determinations, the NZCC has chosen not to apply its rate determination retroactively.

The NZCC has identified a number of criteria that it considers to be relevant in the exercise of its discretion to backdate:

- the purpose of the Telecommunications Act, which is to promote competition in telecommunications markets for the long-term benefit of end-users;17
- whether backdating would be “demonstrably efficient”;
- whether backdating would “demonstrably promote competition in a way that is likely to directly benefit end-users”.18

In recent decisions, the NZCC expressed the view that backdating would not best give effect to the purpose of the Telecommunications Act.19 In those decisions, retroactive application would have required access seekers to repay Chorus (the access provider), because final rates determined by the NZCC were higher than the interim rates. In light of the likely impact on investors, retail telecommunications providers and end-users, the majority of Commissioners considered that backdating would not promote competition for the long-term benefit of end-users.

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16 Telecommunications Act 2001, s 59.
17 Telecommunications Act 2001, s 18.
19 New Zealand Commerce Commission, Final pricing review determination for Chorus’ unbundled copper local loop service [2015] NZCC 37 (UCLL determination); New Zealand Commerce Commission, Final pricing review determination for Chorus’ unbundled bitstream access service [2015] NZCC 38.
The NZCC considered the following factors to be of particular relevance to its decision on whether to apply rates retroactively:

- **Impact on long-term infrastructure investment incentives:** In response to submissions that argued backdating would have a detrimental effect on investment, the NZCC agreed that uncertainty would be detrimental.\(^{20}\)

- **Impact on access seeker competition:** It was argued in submissions that backdating may mean that access seekers would innovate less and increase prices due to uncertainty. The NZCC’s view was that access seekers operated in a competitive market that meant that price increases could not be fully passed through to end users even if backdating resulted in requiring access seekers to make a lump-sum payment to the access provider.\(^{21}\)

- **Incentives to delay the FPP process:** The NZCC agreed with submissions arguing that failure to backdate creates an incentive to delay for one party or another, however, the NZCC highlighted its significant discretion and control of the FPP process as a mitigating factor against unnecessary delays.\(^{22}\)

While the CRTC’s decision to backdate the HSA final rates advantages access seekers, this New Zealand experience demonstrates that, once the principle of unrestricted backdating of varied rates is accepted, it can also work against access seekers in future determinations.

### 6 Conclusion

A central feature of ex ante regulatory regimes – in which access charges are set on an industry wide basis – is that the rates determined by the regulator will apply for a fixed period. The rationale is, by providing certainty and predictability for access seekers and access providers alike, to create conditions for efficient future behaviour, including efficient investment, operation and use of critical infrastructure.

If the regulator has broad power, at any time during the term of its final determination, to go back in time and remake that decision, setting rates for a fixed term can be meaningless. There is also no guarantee that, having re-opened and retroactively remade its original decision once, the regulator will not be minded to repeat the pattern again in the future, re-opening and retroactively remaking its varied decision.

The investment uncertainty created by the potential for retroactive rate setting can swing in both directions – while, in this case, the CRTC’s retroactive rate setting benefits access seekers, the New Zealand case discussed above illustrates that access seekers also can be at risk of retroactive application of revised higher access charges.

It is for these reasons that the UK, Australia and New Zealand have safeguards described above which would preclude their regulators making the decision the CRTC has made in the HSA case.

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\(^{20}\) UCLL determination, [976]-[979].

\(^{21}\) UCLL determination, [986]-[988].

\(^{22}\) UCLL determination, [1013].