



Economic analysis of sub-loop access

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TABLE OF CONTENTS

1. INTRODUCTION	3
Background	3
Summary of main conclusions.....	3
Structure of this Report.....	4
2. SUB-LOOP ACCESS.....	5
3. HOLD UP IN THE CASE OF THE UNBUNDLED SUB LOOP	5
Incentive to engage in hold-up.....	6
Risk of hold-up in the future	7
Are the circumstances of the sub-loop likely to raise hold up issues?	9
4. SPECIFIC COMMENTS ON DR ARON'S REPORT	10
Key conclusions	10
Demand for sub-loop	11
Likely effect on the LTIE.....	13
Regulatory context and processes	14
Cost benefit analysis.....	15

1. INTRODUCTION

Background

The G9 consortium of telecommunications network operators has asked CEG to provide a paper on economic aspects of regulating access to the local loop. In particular, the G9 consortium has asked that we consider the potential benefits from regulating access to unbundled local loop services at points other than as presently defined in the 'declared service description'.

CEG has also been asked to provide comment on a "Report of Debra J. Aron" dated 15 June 2007¹, which was prepared in response to the Australian Competition and Consumer Commission (the Commission) paper "Unconditioned Local Loop Service – An ACCC Discussion Paper examining possible variation of the service declaration for the unconditioned local loop service"².

This report was prepared by Mr Jason Ockerby and Dr Tom Hird.

Summary of main conclusions

The key findings of this report are:

- Regulating access to the local sub loop may prevent a 'hold up' in efficient investment in telecommunications infrastructure which is specific to the copper local sub-loop.
- As the monopoly owner of the sub-loop Telstra has an incentive to hold up investment in the deployment of a fibre network (either by itself or a third party) to secure regulated terms of access that are above cost.
- Even if Telstra were willing to provide access to the sub-loop, without regulated access, access seekers and Telstra may be prevented from negotiating access that will allow an efficient level of access and investment because of the potential for hold up in the future.
- The 'success' or otherwise of unbundling in other jurisdictions may not be a good indicator of the future of unbundling in Australia, at either the local loop or sub loop level.
- The proposal by the G9 consortium and the competitive bidding process proposed by Government indicate a likely demand for the access to the sub loop in Australia. It is reasonable that the Commission take this into account when assessing likely demand for a regulated sub-loop access service.

1

<http://www.accc.gov.au/content/item.phtml?itemId=791354&nodeId=722fab25d88bcba7028bf8cd4b6fbdf7&fn=Telstra%20annexure%20%20-%20Aron%20Report.pdf>

2

[http://www.accc.gov.au/content/item.phtml?itemId=787523&nodeId=67a498cb0d670067421781579c2f780c&fn=ACCC%20discussion%20paper%20-%20possible%20variation%20of%20ULLS%20service%20declaration%20\(May%2007\).pdf](http://www.accc.gov.au/content/item.phtml?itemId=787523&nodeId=67a498cb0d670067421781579c2f780c&fn=ACCC%20discussion%20paper%20-%20possible%20variation%20of%20ULLS%20service%20declaration%20(May%2007).pdf)

Structure of this Report

The remainder of this proposal is structured as follows:

- Section 2 sets out the background and context of the report.
- Section 3 provides our analysis of the economics of hold up in the local sub loop.
- Section 4 addresses some specific issues raised in the Report of Dr Aron.

2. SUB-LOOP ACCESS

The G9 consortium of telecommunications network operators has proposed a variation to the service description of the unconditioned local loop service. We understand that the effect of this variation is to allow access to the local loop at a point closer to the end-user's premise (the sub-loop). It is argued that this will facilitate the installation of equipment closer to the end-user's premise. We rely on the submission on the G9 that:³

The ability to acquire access to the ULLS at locations other than the location of the Telstra customer access module will be significant in the context of a roll out of 'fibre-to-the-node' (FTTN) network. If an FTTN roll out were to occur, whether by Telstra or another entity such as the G9, then the communications wire would be removed and replaced with fibre between the location of the existing customer access module and a location closer to the end users' premises (the 'node'). That is the 'local loop' would be truncated and communications wire from the end users' premises would terminate at the node."

The particular points of access (the nodes) required to facilitate the FTTN are not the subject of this report. However, we note that it would be a relevant consideration for the Commission to consider the impact of any specific access point and the consequent benefits to end-users from granting access at those points.

3. HOLD UP IN THE CASE OF THE UNBUNDLED SUB LOOP

There are currently at least two proposals to invest in fibre to the node networks in Australia. The first is by Telstra, the owner of the sub-loop. The second proposal is that of the G9 consortium, which will require access to the sub-loop in order to deploy its fibre network.

This situation gives rise to two concerns which can be addressed by regulating access to the sub-loop. Both concerns can be described as a form of economic 'hold up' on efficient investment. The concerns are as follows:

1. Telstra's ownership of the sub-loop allows it to delay (potentially efficient) investment in a fibre to the node network whilst it seeks to reach an agreement with the regulator or Government that protects any monopoly profits. Its ability to deny access to the sub-loop strengthens its negotiating position.
2. Even if Telstra were willing to provide sub-loop access, the lack of regulated terms of access may prevent Telstra and access seekers from commercially negotiating an efficient arrangement for access to the sub-loop because, if the commercial contract can not cover all eventualities (which it cannot), the parties risk being 'held up' in the future.

3

[http://www.accc.gov.au/content/item.phtml?itemId=785118&nodeId=1d3877aef48a89d586351f2acfc2fa4d&f n=G9%20request%20for%20amendment%20to%20ULLS%20service%20description%20\(Mar%2007\).pdf](http://www.accc.gov.au/content/item.phtml?itemId=785118&nodeId=1d3877aef48a89d586351f2acfc2fa4d&f n=G9%20request%20for%20amendment%20to%20ULLS%20service%20description%20(Mar%2007).pdf)

Each of these concerns is considered below.

Incentive to engage in hold-up

Telstra has announced that it is to delay its own investment in a fibre to the node network until it can gain certainty regarding the terms it would be required to provide access to that network.⁴ A delayed investment may have a value to Telstra because once committed it loses the option to change or further delay its investment.⁵ There may be many other reasons to delay investment.⁶

We understand that the fibre to the node investment proposed by both Telstra and the G9 is dependent on the use of the copper sub-loop. That is, neither proposal can proceed without access to the copper loop running between the 'nodes' and the end-users' premise. As the owner of a monopoly network that is an essential input into the deployment of a high-speed broadband network, Telstra is in a unique position to capture potential benefits by delaying investment.

Governments (and regulators) have an interest in seeing efficient investment proceed. Inefficiently delayed investment is costly to end-users because it means that they lose the entire potential surplus from consuming the services derived from that investment for the period of the delay.

In Australia, the Government has enacted regulatory arrangements to give investors certainty regarding new investments before they proceed. Investors can submit special access undertakings which set out the terms of access the investor is willing to grant to third parties⁷. These terms of access materially affect the investor's return on investment as the terms will set payments by access seekers for use of the network. These terms will have consequential effects on competition in downstream markets and the potential gains to the investor if they participate in those markets.

Whilst Telstra has in large part bypassed these specific regulatory arrangements (ie, it has not submitted a special access undertaking) it is widely understood that it has sought to agree the terms of access with both the Commission and the Government. The dominant strategy for Telstra in such negotiations would be to present a 'take it or leave it' offer on the basis that it is the only party that can build the network. The level of the offer would rationally seek to set

⁴ http://www.telstra.com.au/abouttelstra/investor/calendar_event.cfm?ObjectID=1262

⁵ See Hausman J. (1998), *The Effect of Sunk Costs in Telecommunications Regulation*, Presented at a conference at Columbia University, October 2, 1998. <http://econ-www.mit.edu/files/1027>

⁶ An investor in large and lumpy capital projects might have a general incentive to delay investment beyond what is optimal for society. From the perspective of society, investment is optimal when that investment maximises the present value of net public benefit from the investment. However, without perfect price discrimination an investor cannot extract all consumer surpluses and therefore capture the full net public benefit for themselves. The investor will confine its assessment of whether to proceed with the investment to the private benefits it can extract and the costs incurred (the private costs are likely to be equal to the society's cost) and hence the incentives on the private investor could lead to inefficient delay.

⁷ Alternatively, investors can apply for 'anticipatory exemptions'.

terms of access that include a rent to reflect the monopoly power granted by the ownership of the sub-loop.⁸

A key requirement for Telstra to engage in this strategy is that other parties cannot bypass the sub-loop and deploy their own high speed broadband network (or get access to the sub-loop on economic terms).

In relation to the opportunity for bypass we note that the Australian Competition Tribunal has observed there is some evidence that bypass has occurred in Australia, however it observed and took into account the Commission's view that such bypass has been fragmented and does not constrain Telstra's market power.⁹

Without regulated access to the sub-loop an access seeker would need to negotiate commercial terms of access to the sub-loop directly from Telstra. In such negotiations Telstra would rationally consider the opportunity cost of not providing access. This would be at least equal to the benefit Telstra would receive if it were to build the fibre network itself (or not build it at all). If Telstra is capable of charging above cost prices for services supplied on the new or existing network then its opportunity cost of providing access to a third party would be similarly inflated.

Therefore, it is unlikely that access seekers could commercially negotiate better terms than the Government or regulator, in the absence of regulated access requirements to the sub-loop.

Risk of hold-up in the future

In the circumstance where an access seeker is required to make a sunk investment into a specific asset such as a fibre to the node network a major concern is that Telstra may opportunistically increase access prices in the future to levels that would expropriate the sunk investment of access seekers (such as FANOC).

This opportunistic behaviour is commonly referred to in the economic literature as 'hold up' (see Box). It arises in this circumstance because the investment by an access seeker to the sub-loop is specific to the copper sub-loop and once sunk Telstra may have the incentive and ability to capture the rents (or quasi-rents¹⁰) on invested capital made by the access seeker.¹¹

⁸ A possible constraint on long term delays is the potential for existing competitors (using the full local loop service) to erode any above cost pricing by Telstra today. However, as these competitors will be effectively stranded by a fibre to the node investment, Telstra's 'offer' would rationally seek to (re)capture any lost monopoly rents.

⁹ Telstra Corporation Ltd (No 3) [2007] ACompT 3 (17 May 2007) at [79] and [80].
<http://www.austlii.edu.au/au/cases/cth/ACompT/2007/3.html>

¹⁰ Quasi-rents in this case would refer to the extra profit the access seeker gets from dealing with Telstra and the profit from the next-best use of the asset (which in this circumstance is likely to be small). See Besanko, Dranaove, Shanely and Schaefer (2007), *Economics of Strategy*, John Wiley and Son, 4th edition, page 124.

¹¹ Even in the case where an access seeker such as FANOC had, ex ante, the option to choose between local access networks, regulated access to the sub-loop may be necessary. Imagine a situation in which there were two (or more) local access networks. In this circumstance it may be considered that competition

In our opinion there are circumstances where commercially negotiated prices for access to the sub-loop may lead to opportunistic behaviour by negotiating parties that hinders negotiations and consequentially deters efficient investment. These circumstances would include:

- Where contracts between the access seeker and the access provider can not be made complete. For example they are not be able to fully anticipate the changing circumstances that may give rise to opportunistic behaviour; and
- The access seeker is required to make a sunk investment in assets that are specific to the network it is seeking access from (or that there is a material cost in adapting or transforming the assets for a competing network); or
- The access provider is locked in to the access seeker's investment.

Economics of Hold Up

Assets that are specific to a particular association or transaction between parties create issues in economics. The issues arise because transaction specific assets cannot be used for another purpose without imposing a cost in transforming the assets for that other purpose. This tends to lock the parties (or at least the party who invests in the asset) into a particular transaction.

Investing in transaction specific assets can be of benefit to the economy, usually in the form of efficiency. For example, a transaction specific asset might be designed to improve efficiency in a production process or it might add value to a service at a unique location.

However, the knowledge that investing in a specific asset will change the bargaining position of parties *ex post* may deter investment in the specific asset. A simple example¹² involves one party investing a lump sum in an asset that has the *sole purpose* of producing a service that is sold to a particular customer and involves no on-going cost (Incremental Cost = 0). Prior to making the investment the parties can negotiate the price of the service based on the value of the service (V) to the buyer and the *ex ante* cost of the investment (equal to the lump sum). However, if no contract is entered into prior to the investment being made then the customer has the ability to hold up the supplier by threatening to use an alternative source of the service.

A Nash bargaining outcome will have the parties equally splitting the difference between the Incremental Cost and the value (V). If the buyer does not sufficiently value the service to

between the networks would constrain prices and price regulation may not be warranted. However, if an access seeker must make an irreversible investment that locks it into a particular local access network the risk of hold up exists.

¹² This example draws on Tirole J. (2000), *The Theory of Industrial Organisation*, MIT Press, Cambridge, Massachusetts.

cover the lump sum, the knowledge of this *ex post* bargaining outcome will deter the initial investment.

Parties can avoid these issues by entering into a contract that cover the life of the investment or by vertically integrating. However contracts may be inefficient if they limit the incentives of parties to minimise costs or limit the opportunity to source alternative arrangements.

A limit on Telstra's ability to engage in hold up is the ongoing viability of the access seeker. However, this is likely to be a weak constraint in this case because the size of the sunk investment is likely to be substantial. That is, most of the cost of the network is sunk up front and the access seeker will have an incentive to continue to trade so long as it can cover its relatively small ongoing expenditures. Also, the alternative if the access seeker were to go out of business may be the acquisition of the assets by Telstra and a re-integration of its network. To the extent that ongoing regulation is superior to long term contracts at dealing with unforeseen events then regulation also provides a potential solution to the risk of future hold up.

In summary, without regulated access to the local loop:

- If access seekers are left to bargain with Telstra on access to the sub-loop the knowledge of the potential to expropriate the investment is likely to deter efficient investment. Without regulated access the investor in the fibre network (the G9) will be vulnerable to Telstra's ability to expropriate a share of the benefits of investing in the network. This would include a share of the innovative, value adding benefits of any on-going investment that enhances the value of the fibre network.
- Similarly, Telstra may be deterred from entering into a long term (but potentially incomplete) contract with an access seeker if it limits its options once the access seeker builds its network. In this circumstance Telstra can have its sunk investment in the sub-loop expropriated by the access seeker, and the knowledge of this potential will likely deter efficient investment.

Which of these effects dominates consideration will be determined by whether Telstra or the potential access seeker has the most options to contract with other parties or vertically integrate. If the sub-loop is a natural monopoly then the access seeker would appear to have fewer options.

Are the circumstances of the sub-loop likely to raise hold up issues?

The circumstances in which a fibre to the node network relies on access to the sub-loop it appear that the risk of hold up is particularly acute. These circumstances include:

1. *Sunk investment:* We understand that the G9 propose to build and lay a fibre network between interconnection points and around 20,000 'nodes' in the streets. We understand that the construction of this fibre network will involve significant material and labour

activity that once made is largely irreversible. This means that the risk of an incomplete contract leaves the G9 materially exposed to hold up by Telstra.

2. *Demand forecasts*: It is difficult for contracts to anticipate all relevant scenarios and events over the long life of the fibre network owner's investment. For example, demand for access to the high-speed broadband services is likely to be very uncertain. It would be difficult to write a contract that captures and gives appropriate incentives for all possible demand scenarios.¹³
3. *Alternative options*: The local loop is likely to be the only viable local access network for the deployment of a fibre network. If however other fibre networks are attractive to the local loop owner (such as aerial fibre networks) the local loop owner (Telstra) will have an incentive to hold up the fibre network investor.
4. *Ongoing investment*: The fibre network is likely to evolve over time and new investment in services and technologies will be needed and should be efficiently encouraged. The unforeseen nature of technological development will make it difficult to capture these in a contract and as such deter parties from entering into a (necessarily) incomplete contract which will leave them exposed to expropriation in the future.

We note that it appears that sub-loop access creates a greater risk of hold up than access to the full copper loop. This is because access seekers using the full loop need to make smaller sunk investments in assets with shorter lives than access seekers using the sub loop (eg, access seekers using the sub loop must invest in expensive and long lived trenching assets that are not required if using the full loop from a Telstra exchange). It also appears likely that access seekers' investment in using the full copper loop (which we understand to be largely DSLAMs) is more salvageable than laying fibre network as is needed in the fibre to the node network.

4. SPECIFIC COMMENTS ON DR ARON'S REPORT

Key conclusions

Dr Aron's key conclusions might be summarised as follows:

- The proposed sub-loop service will create costs to Telstra that would harm the interests of end-users if demand for the service is not realised.¹⁴

¹³ Indeed, the commonly cited case of hold-up, the Fisher Body – General Motors case arose because the contract designed to prevent hold up did not account for a substantial increase in demand for the car bodies subject to the contract- demonstrating that such contracts seek to resolve but can also create hold-up issues. See Klein (1988), "Vertical integration as organisational ownership: The Fisher Body-General Motors Relationship Revisited" *Journal of Law Economics and Organisation*, Volume 4 (1).

¹⁴ Dr Aron's also presents a view that a general obligation to unbundle at the sub-loop level imposes costs on the access provider that will be "incurred whether or not demand for the unbundled element materializes". Dr Aron relies on a Technical Document to reach this view, but it is unclear whether these costs would be incurred if there was no request for access. Also, many of the costs appear to relate to line by line sub-loop

- Regulating access at the sub-loop level may have an uncertain effect on the long term interests of end-users (the LTIE), even if demand were clearly evident.
- It would be 'prudent' to set aside the proposed service variation as it is too nebulous (on the basis that it creates an unlimited number of access points) and to wait to consider specific services description proposal as they arise.

The bulk of these conclusions rely on particular assumptions regarding the current context of the regulatory debate, the likely demand for the sub-loop and available regulatory processes. We would largely agree with the analysis of Dr Aron but for these assumptions.

In particular, Dr Aron assumes that:

- There is likely to be little demand for sub-loop and this is evidenced by analysis from overseas jurisdictions.
- That the specific proposal of the G9 (via the FANOC special access undertaking) is not a relevant consideration in examining the likely effect on the LTIE.
- There is an alternative process by which access seekers could put forward a specific proposal for access to the sub-loop.

Each of these is considered in turn. In addition we make some observations on the proposal of Dr Aron to implement a "detailed cost/benefit analysis"¹⁵.

Demand for sub-loop

The likely demand for access to the sub loop will be dependent on the economics of access. This will at least depend on the price of access and the alternatives available to competitors (eg, bypass using their own facilities or other access services such as line sharing). We agree with Dr Aron that it "would be prudent to examine the possible sources of future demand at these proposed new locations"¹⁶.

The special access undertaking (SAU) submitted by FANOC and the Government's competitive bidding process appear to us to be relevant considerations for the Commission in determining whether there will be likely demand for access to the sub-loop. For example, whilst the Government's Expert Taskforce draft guidelines appear technology neutral they

unbundling rather than 'pillar migration' as appears to be the basis of the G9 request. More detailed analysis of these cost claims is necessary.

¹⁵ Page 3

¹⁶ Page 13

recognise that a fibre to the node network based on access to the copper sub-loop is a feature of existing proposals and will require regulatory intervention.¹⁷

We note that at 15 June 2007, the time at which the report of Dr Aron was prepared, Dr Aron would not have been aware of the Government's Expert Taskforce which was announced on 18 June 2007.¹⁸

In relation to the evidence of demand for sub-loop access, Dr Aron largely relies on the paper of Mr Scott Wallsten¹⁹. We note that the context of Mr Wallsten's assessment of the success of sub-loop access primarily relates to regimes that allow line-by-line unbundling which may have questionable economics.²⁰ It is therefore relevant to consider the context of the G9 proposal in terms of "pillar migration". Either way, we agree with Dr Aron that there may be a depressing effect on investment from unbundling that is a relevant consideration for the Commission. However, the observed effect of Telstra holding up investment in the fibre network is an equally relevant consideration.

In terms of other evidence on the likely demand for sub-loop access, we find it difficult to draw strong conclusions from the success or otherwise of unbundling generally, domestically or internationally. We note that information on the extent of local loop access in Australia is limited, though a recent Telstra report highlights the extent of local loop competition in Australia in particular areas. The figure below is extracted from that report.²¹

¹⁷ http://www.dcita.gov.au/data/assets/pdf_file/71950/Expert_Taskforce_Draft_Guidelines.pdf

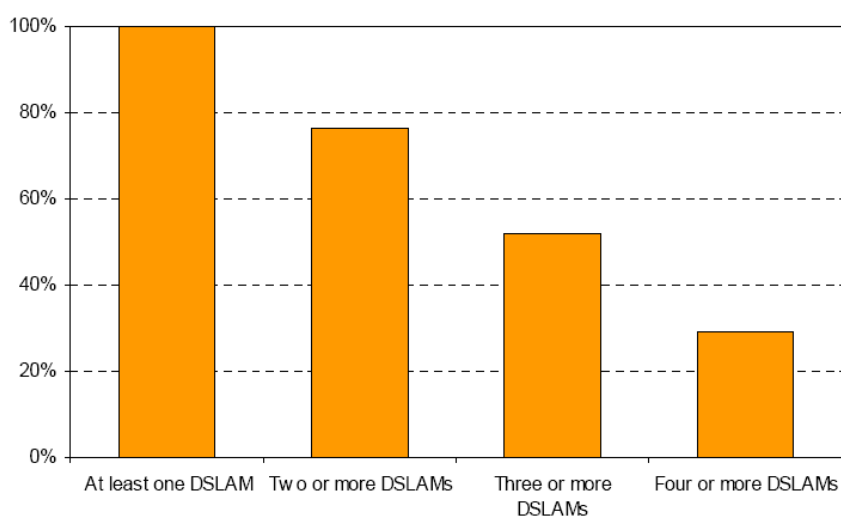
¹⁸ http://www.dcita.gov.au/communications_for_consumers/funding_programs_and_support/australia_connected/expert_taskforce

¹⁹ Wallsten, S., *Broadband and Unbundling Regulations in OECD Countries*, Joint Center for Regulatory Studies, Working Paper 06-16, June 2006.

²⁰ See for example, Analysis, *The business case for sub-loop unbundling in the Netherlands*, Final Report for OPTA, 26 January 2007. <http://www.opta.nl/download/Analysys+Final+Report%2Epdf>

²¹ Telstra Corporation Limited, Submission to the Australian Competition and Consumer Commission, Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications, Supporting Submission, PUBLIC VERSION, July 2007. <http://www.accc.gov.au/content/item.phtml?itemId=791981&nodeId=a37042297168609ed97333833f7507e7&fn=Telstra%20LCS%20&%20WLR%20exemption%20application%20-%20main%20submission.pdf>

Figure 2: Percent of ESAs in the Exemption Area covered by competitor DSLAMs



Source: Telstra analysis based on [c-i-c].

Likely effect on the LTIE

In our opinion the assessment of whether to regulate access requires the Commission to define a reasonable set of scenarios which will be facilitated by regulation and then to consider the impact of these on the long term interests of end-users (LTIE). The proposal by FANOC and the Government's competitive bidding process appear to be relevant considerations for the Commission in determining whether there will be likely demand for access to sub-loops. If these are to proceed, regulated access to the sub-loop will be needed.

Similarly, it is relevant that the G9 request requires statutory changes in order to proceed and this has important implications for the Commission's decision making. A key requirement is the legislation for "pillar migration".²² However, as mentioned above these changes appear to be under active consideration by the Government as part of its Expert Taskforce.

If assessed in isolation we note that a number of procedural steps in achieving the G9 proposal (eg, regulating sub loop access, legislating for pillar migration and acceptance of a special access undertaking) may not be reasonable, but together may be determined to have a pro-competitive effect. It would not be reasonable to argue "regulation of the sub loop should not be considered until legislation for pillar migration has been passed" while simultaneously

²² Statutory Amendments to Facilitate Competitive Proposals for the Construction of an Australian Next Generation Broadband Network Submission to The Federal Government by the G9 Consortium, Dated 30 May 2007.

<http://www.accc.gov.au/content/item.phtml?itemId=788724&nodeId=6ed5bae23f52809c387f899966a9d8da&fn=Schedule%205%20-%20Request%20to%20government%20for%20legislative%20change%20to%20facilitate%20the%20connection%20of%20FANOC%20nodes%20to%20Telstra%20pillars.pdf>

arguing “legislation for pillar migration should not be passed until there is regulated access at the pillar”. Such arguments are of the “Catch-22” variety.

Regulatory context and processes

Dr Aron’s concludes that not regulating the sub loop access:²³

*“risk[s] very little possible harm to the LTIE because proposed change to unbundling obligation can, **I understand**, be considered in the context of specific plans by competitors, possibly in the context of an SAU.” [emphasis added]*

However, the basis upon which Dr Aron has reached the conclusion that not enacting the proposed changes would not harm the LTIE appears to be incorrect. In particular, we are instructed that:

- the provision of access to the sub-loop can only be compelled by the Commission to the extent that the sub-loop is a regulated service; and
- an SAU only has a binding effect on the party that submits the undertaking, it has no regulatory force in respect a third party. Therefore, a competitor (such as FANOC) cannot, by submitting a SAU, oblige Telstra to provide access to a service that is not currently a regulated service.²⁴

We note that Dr Aron goes on to state that “*it would be appropriate and prudent for the ACCC to ... consider requests for atypical interconnection as part of the SAU process or another process by which the details and implications of a specific plan to provision a network using the proposed interconnection can be assessed*”²⁵. The context outlined by Dr Aron, in which consideration of sub-loop access would be appropriate and prudent, appears to be the precise context of the current application. That is, as discussed above, in considering the variation of the service declaration for ULLS of the Commission might reasonably take into account the likely demand and the competitive circumstances set out in the undertaking submitted by FANOC and the request for amendment of the service description to allow sub-loop access.

Our instruction is that the Commission can, after holding the public inquiry, vary the service description in a manner that is different from the proposal put forward by the G9 but is in the LTIE. Therefore, were the Commission to find that unlimited points of access creates undue costs on Telstra, this could be addressed by the Commission.

²³ Page 18

²⁴ The SAU process can be used to specify the terms on which access will be provided to a service that is not yet a regulated service. However the SAU process is voluntary. Neither a competitor wishing to gain access to the sub-loop nor the Commission have the power to compel Telstra to submit an SAU in respect of the sub-loop.

²⁵ Page 18

Cost benefit analysis

To the general question of whether mandatory access to the sub loop should be made available, Dr Aron says that a determination “of whether the additional unbundling is in the LTIE would, therefore, require detailed cost/benefit analysis”²⁶. In our view a cost benefit analysis that identifies the net benefits of providing access to the sub loop may not be consistent with promoting the LTIE.

A typical cost benefit analysis would identify a benefit to consumers from lower prices if this arises from increased competition but this would be offset by a cost in terms of reduced profits to the supplier. That is, a gain in consumer surplus from lower prices might not add to total surplus as it reduces producer surplus.

Arguably, the criterion to promote the LTIE indicates that gains to end-users are the primary consideration – this could be termed a consumer welfare standard. Under this standard, reductions in producer surplus are discounted in the assessment of cost and benefit.²⁷

A cost benefit analysis might also identify additional gains to both consumers and producers from *additional* sales at prices that are closer to (but perhaps above) cost.

²⁶ Page 3

²⁷ For example, in terms of the Part XIC criterion the interests of the access provider are limited to those that are “legitimate”. That is those do not include monopoly profits. See Telstra Corporation Limited [2006] ACompT 4 (2 June 2006)

*“... legitimate business interests require that Telstra be allowed to recover its costs of supplying the LSS [line sharing service] and achieve a normal return on its invested capital. The expression “legitimate business interests” is a general expression and is somewhat open-textured. What is “legitimate” conduct or a “legitimate” interest in business may be open to a number of differing interpretations. We consider that a carrier’s “legitimate business interests” is a reference to what is regarded as allowable and appropriate in commercial or business terms. In the context of s 152AH(1)(b), the expression connotes something which is allowable and appropriate when negotiating access to the carrier’s infrastructure. When looked at through the prism of a charge term and condition of access and its relationship to a carrier’s cost structure, **it is a reference to the interest of a carrier in recovering the costs of its infrastructure and its operating costs and obtaining a normal return on its capital.** [emphasis added]*