EUROPEAN COMMISSION

Technical panel 2

Price distortions

LLU hearing
8 July 2002

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DG Competition

Conclusion SSD report

- ➢ **In at least 10 EEA States, new entrants report that the margin between incumbent's retail ADSL prices and the prices charged for full or shared LLU access do not allow new entrants to offer service at a profit**

- ➢ **In at least 5 EEA States, new entrants identify a margin squeeze between retail and wholesale prices for the incumbent's ADSL product**

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Aim of this panel

" **Do not dwell in the past, do not dream of the future, concentrate the mind on the present moment**"

Buddha

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Definition

◆ <u>Price squeeze</u> **occurs where the difference between retail and wholesale prices does not suffice to cover the** <u>incremental downstream cost</u> **of providing that service and to generate an acceptable** <u>contribution to the profits</u> **over** <u>a reasonable time horizon</u>

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incremental instead of variable costs

◆ **Economic definition: Average incremental cost ("AIC") "… the difference in the firm's total cost with and without service X supplied, divided by the output of X. (*DPAG Decision of 20 March 01)***

◆ **The cost per unit of X that is added to the firm's total expenses as a result of its supply of the current output of X.** (*Baumol/Sidak, Toward Competition in Local Telephony (MIT Press 1994), page 57*).
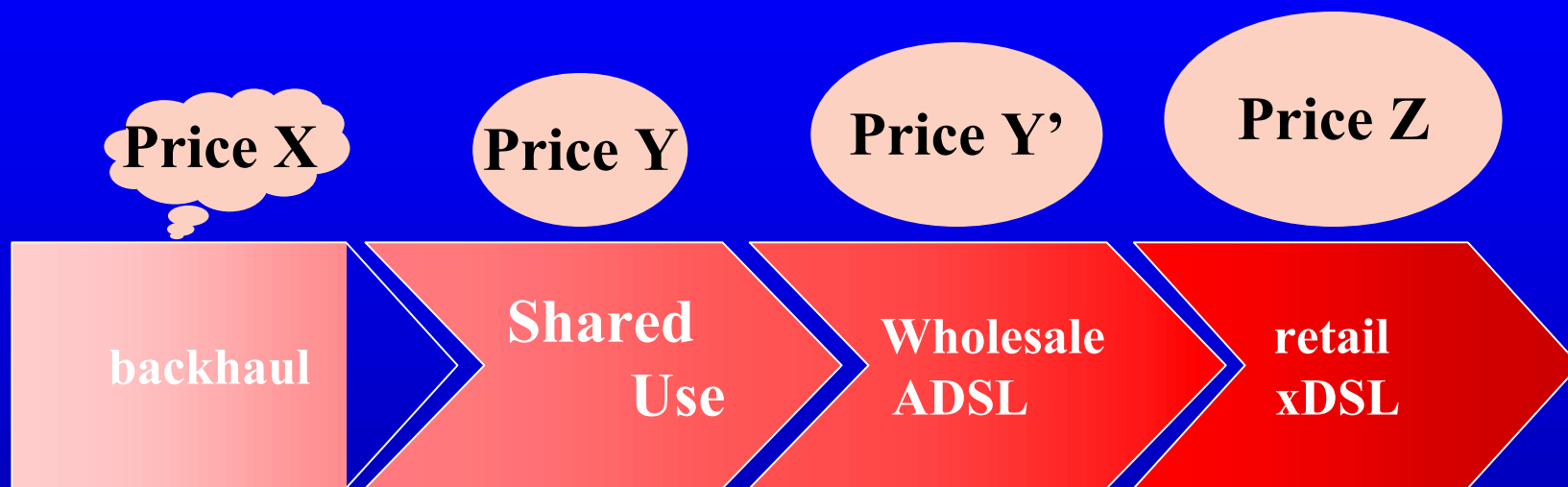
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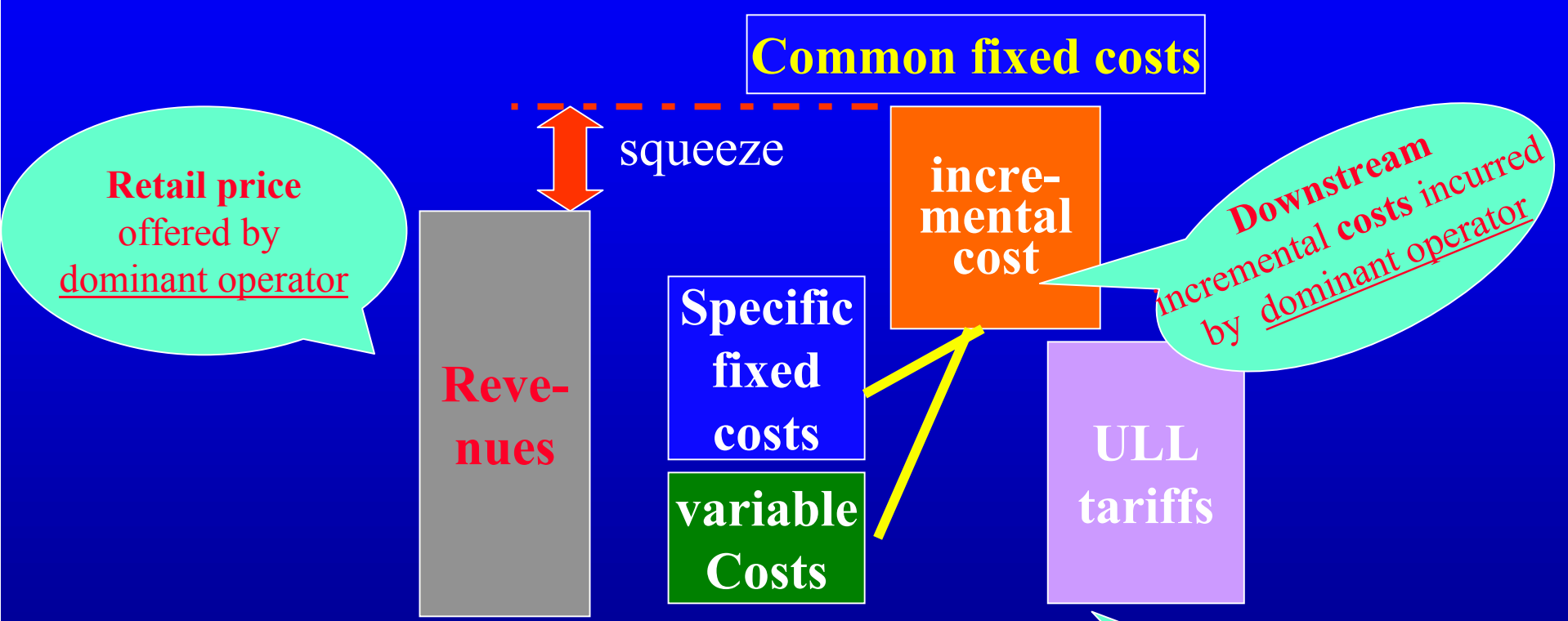
Methodological issues

- **need to establish what is a reasonable profit margin (contribution to common costs)**

- **need allocating the incremental fixed costs : therefore need to establish time horizon**

- **some inputs can be used for various retail services - therefore : need to examine on case- by- case basis which unbundling charge(s) to compare with which retail price(s)**

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Input used for single product

Price X **Price Y** **Price Y'** **Price Z**

| backhaul | Shared Use | Wholesale ADSL | retail xDSL |

☞ available prices incumbent for access at different stages

☞ What is the margin left ?

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Input used for more products

Price X

Price Y²

Different prices

Different prices

| backhaul | Full unbundling | Wholesale voice ISDN ADSL | Voice ISDN xDSL |

☞ **1 : comparison product per product**

+

☞ **2 : averaging**

Single product approach
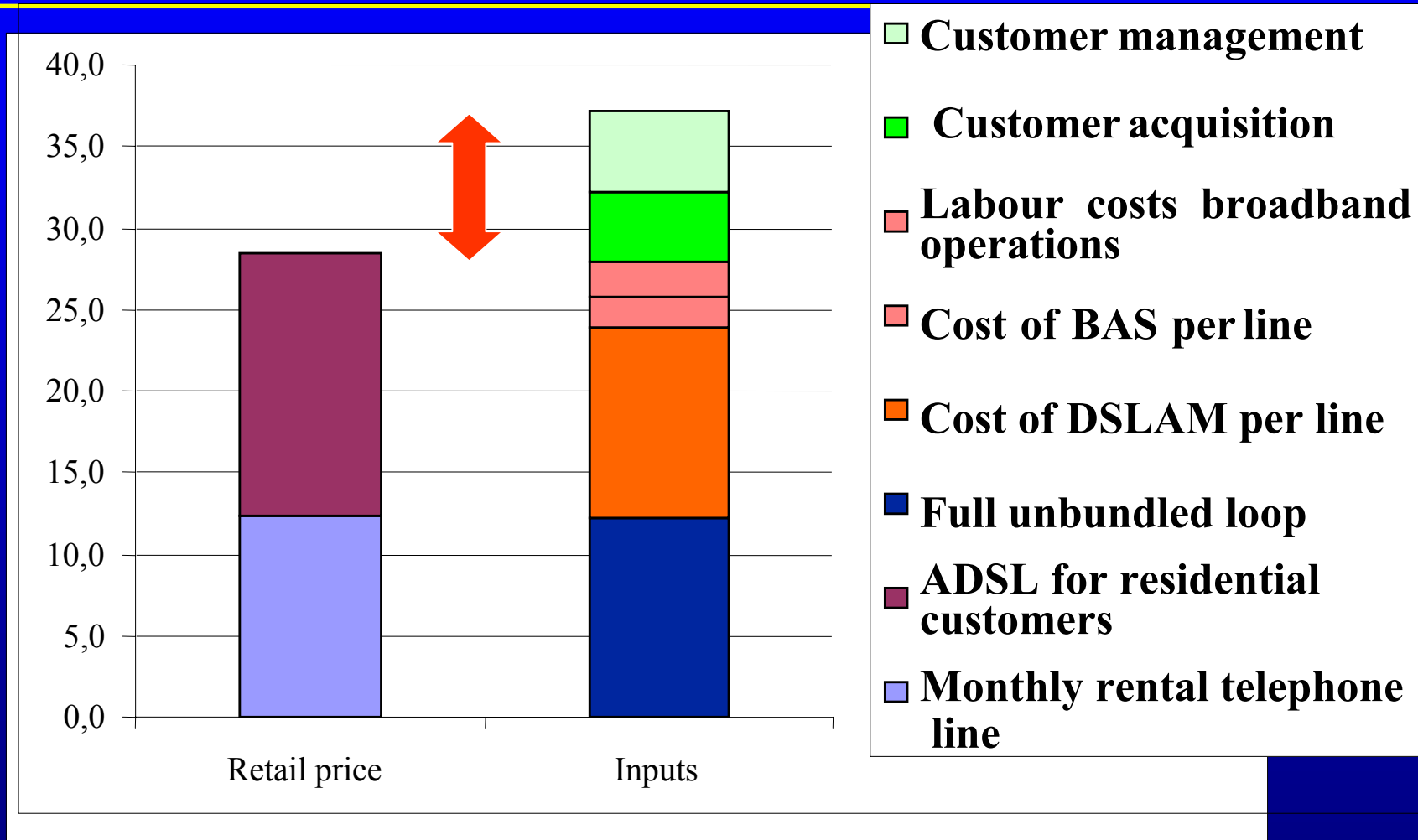
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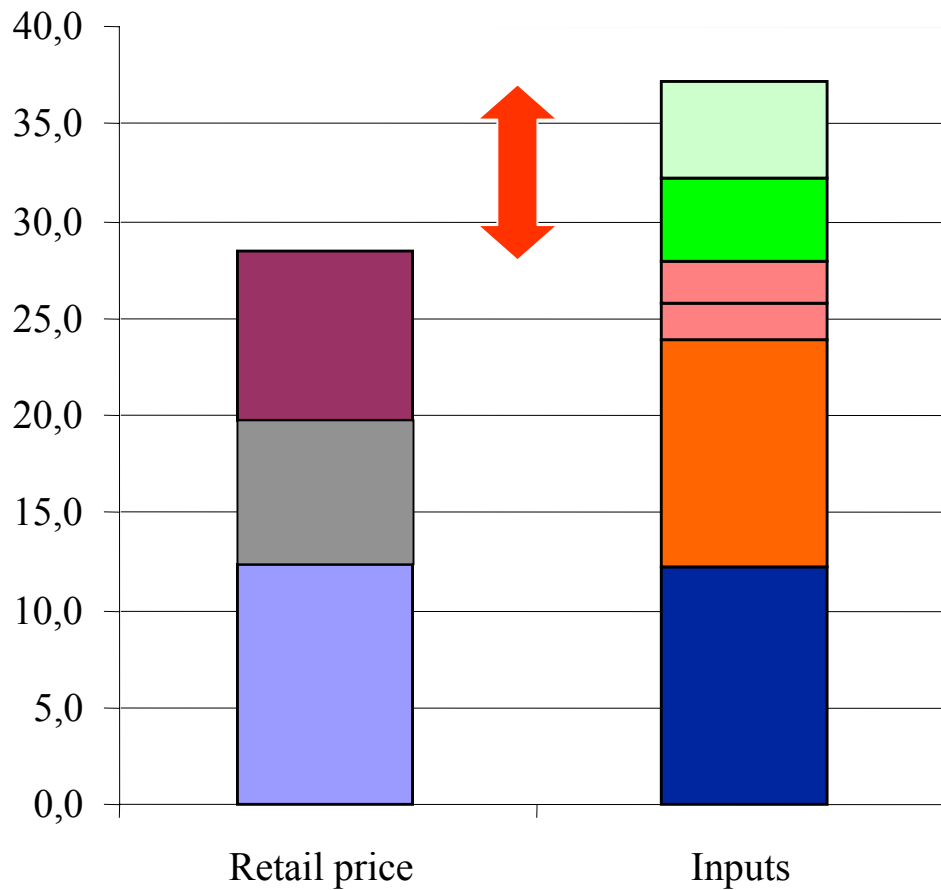
The basket approach (1)
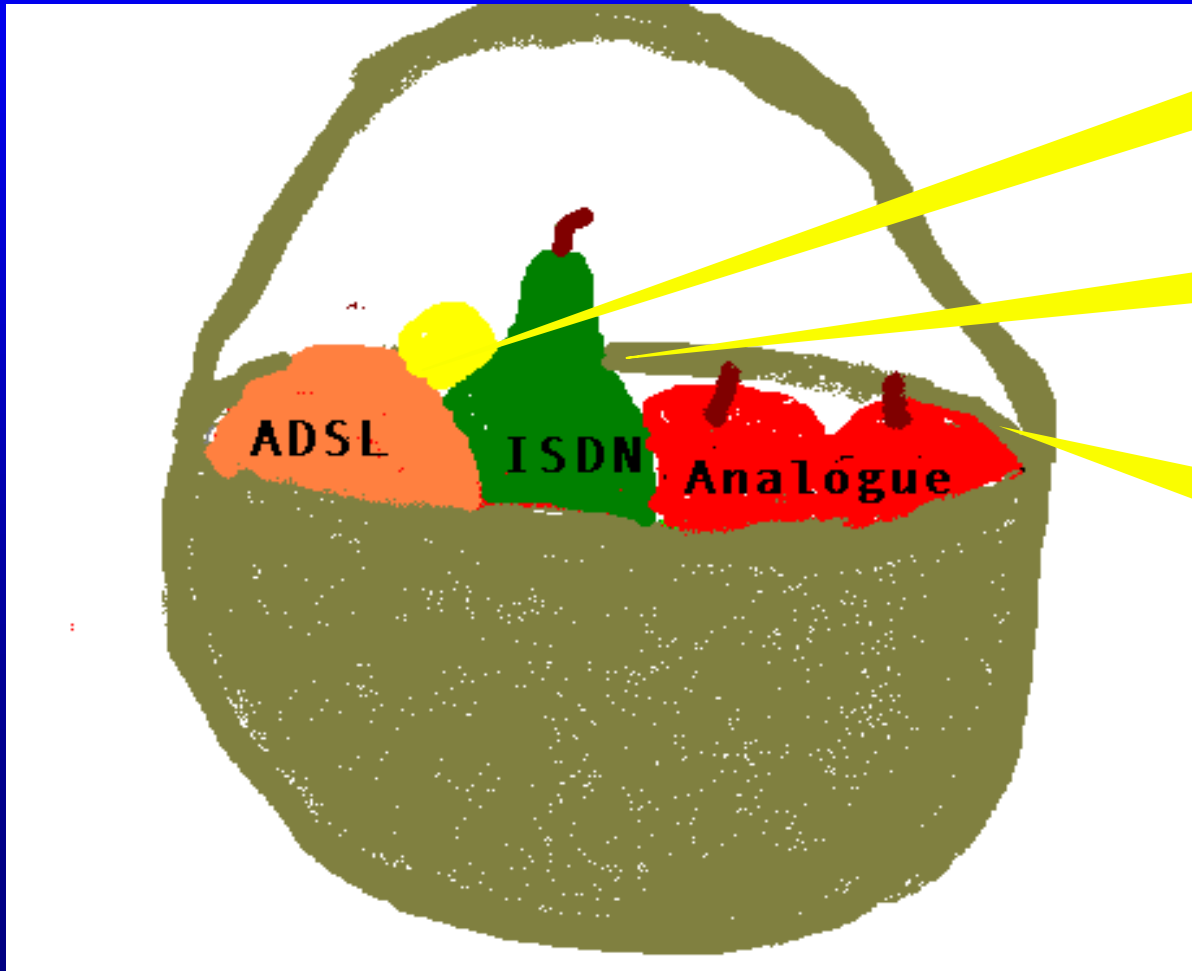
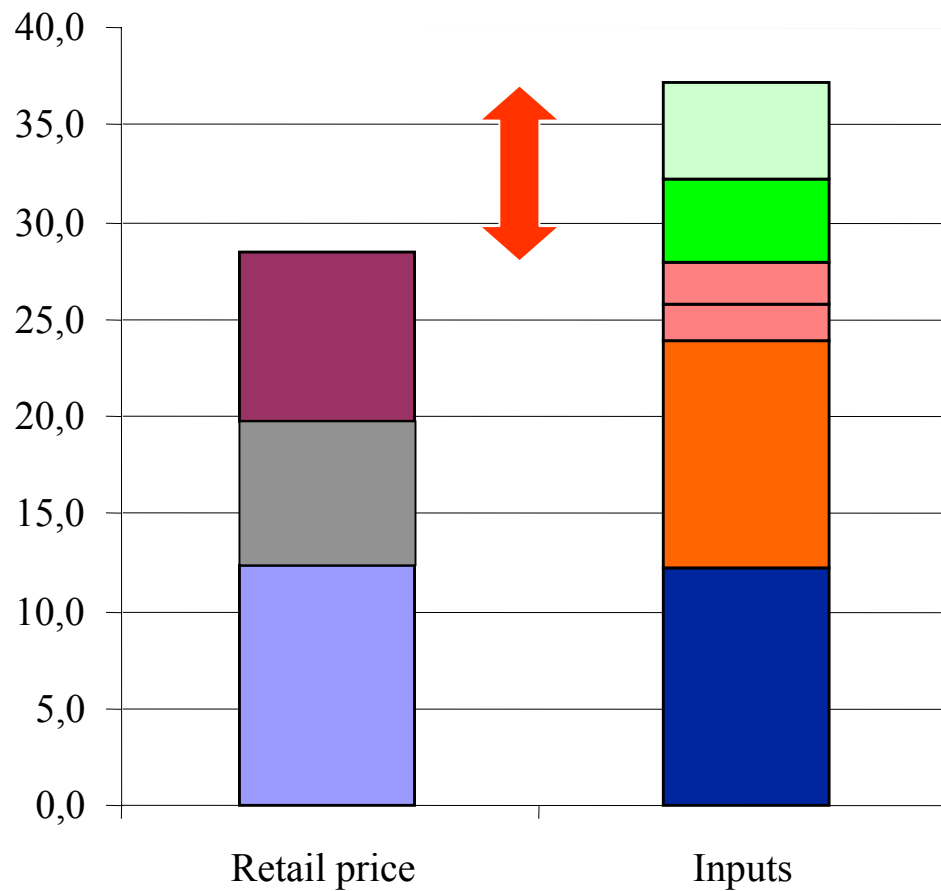

ADSL

ISDN

voice

petition

The basket approach (2)

➢ **Assumption : competitor must be in a position to compete on the same grounds as the incumbent**

➢ **i.e. to have exactly the same basket of services and customers as the latter**

➢ **therefore : retail price = weighted average of the prices of the various retail services supplied by the dominant operator**

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The basket approach

The efficient competitor test

Cost entrant !!!

- ☐ **Customer management**
- ☐ **Customer acquisition**
- ☐ **Labour costs broadband operations**
- ☐ **Cost of BAS per line**
- ☐ **Cost of DSLAM per line***
- ☐ **Full unbundled loop**
- ☐ **Weighted average ADSL**
- ☐ **Weighted average ISDN**
- ☐ **Weighted average monthly rental**

Chart axis: 40,0 / 35,0 / 30,0 / 25,0 / 20,0 / 15,0 / 10,0 / 5,0 / 0,0

Retail price   Inputs

"To avoid criticism, do nothing, say nothing, and be nothing."

_-_

**Elbert Hubbard**

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What are the views of industry?

◆ *Dr Andrea Camanzi, Telecom Italia*

◆ *Andrea Costa, Wind*

◆ *Rainer Lueddemann, Breko, Thomas Plueckebaum (Isis) and Norbert Nolte*

◆ *Simon Hampton, AOL*

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