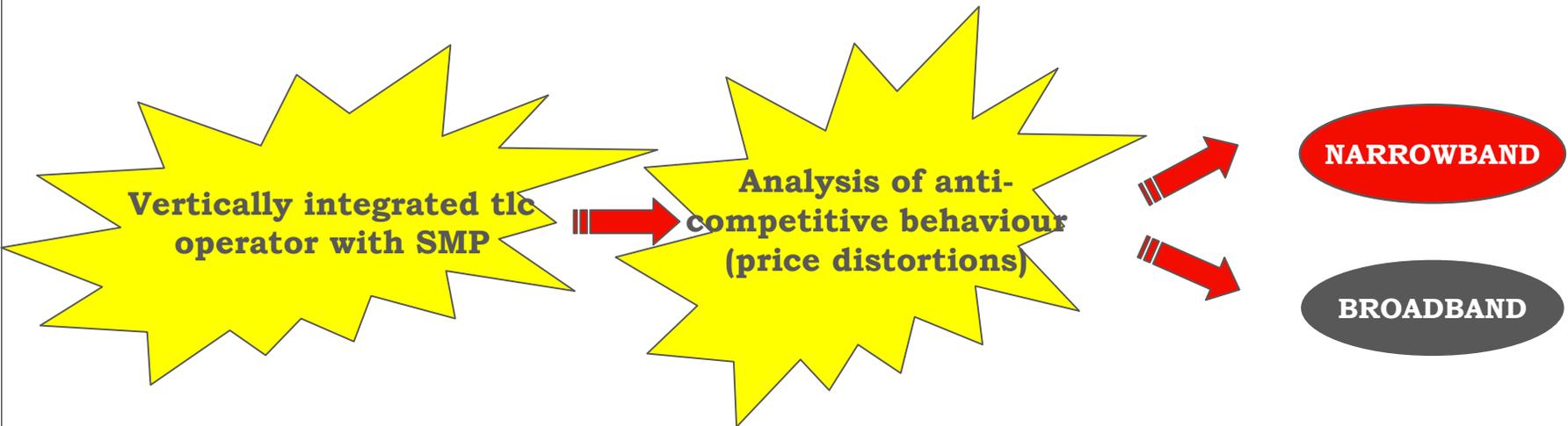


Price Distortions

- The analysis of Price Distortions is strictly related to the principle of non discrimination and equal treatment
- Any analysis of price distortions requires a necessary distinction between NARROWBAND (Voice + Internet Dial Up) and BROADBAND



Price Distortions: NARROWBAND

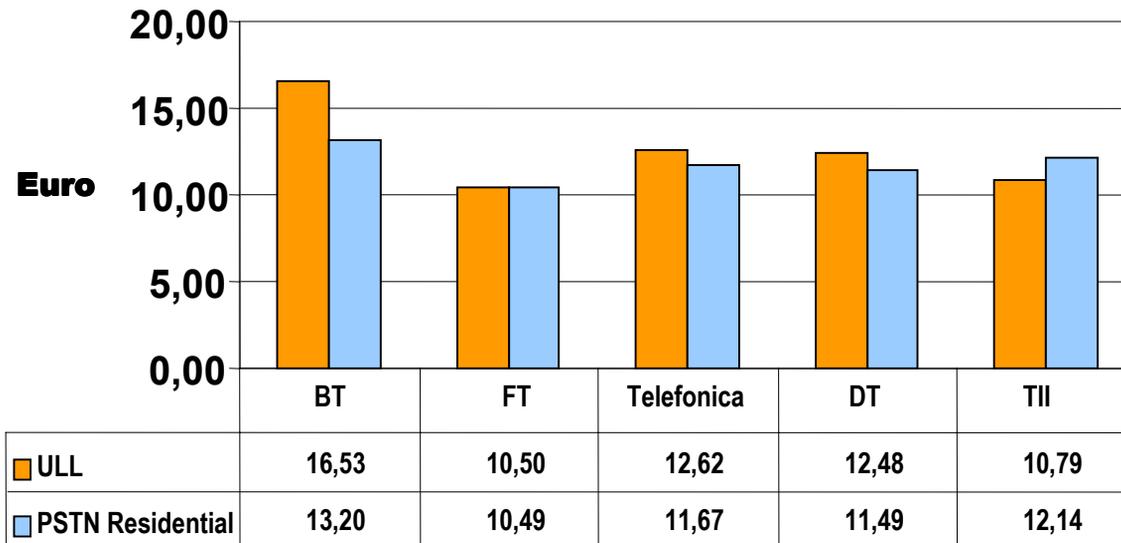
In a NARROWBAND context, price distortions can be determined by regulation

Local Loop Unbundling does:

- **Provide a final service – Local Access Retail Service**
- **Substitute an intermediate service – Call Origination**

Price Distortions: NARROWBAND (2)

Monthly Subscription Charge: ULL vs PSTN Residential Access



Country

Price Distortions: NARROWBAND (3)

Italy Case

Italy is the only large European country where the price of ULL is lower than the monthly charge of PSTN residential access, thanks to the tariffs rebalancing,

It could be profitable for OLOs to invest in ULL



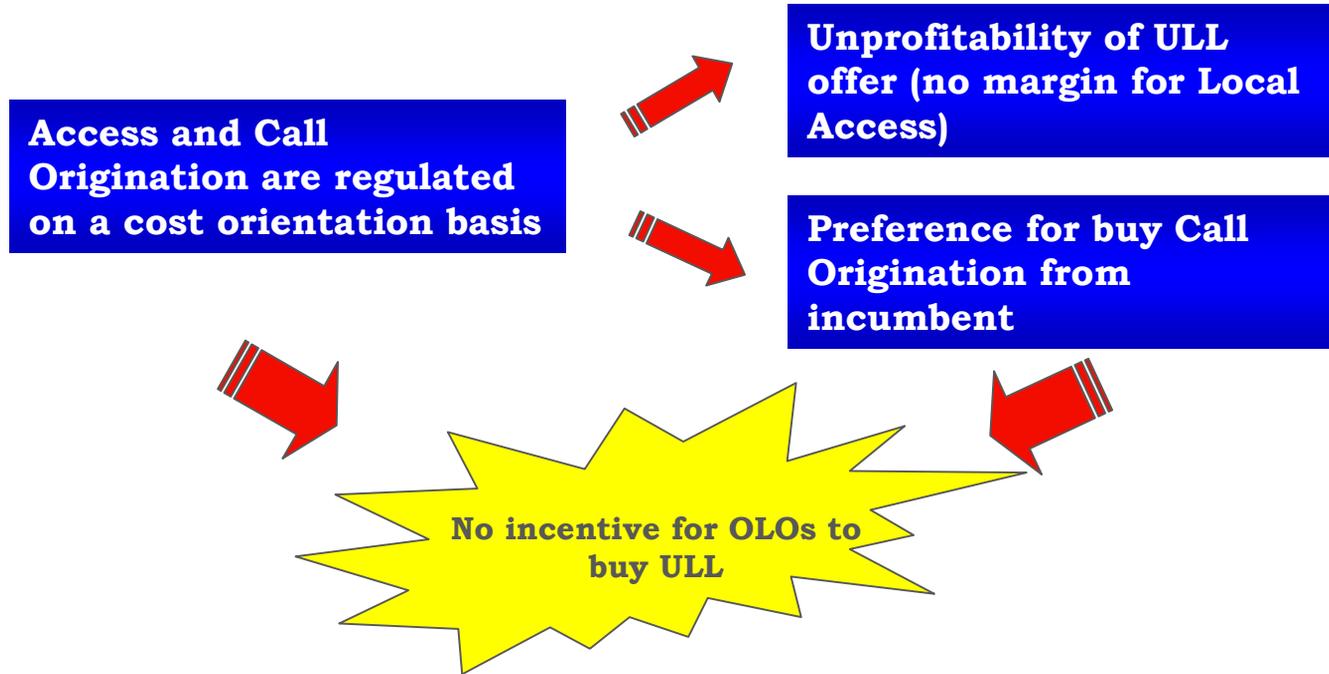
BUT

The maximum rate of return on invested capital (WACC) is set by regulator at too low level (13,5%) for the investment to be profitable




No incentive for OLOs to buy ULL

Price Distortions: NARROWBAND (4)

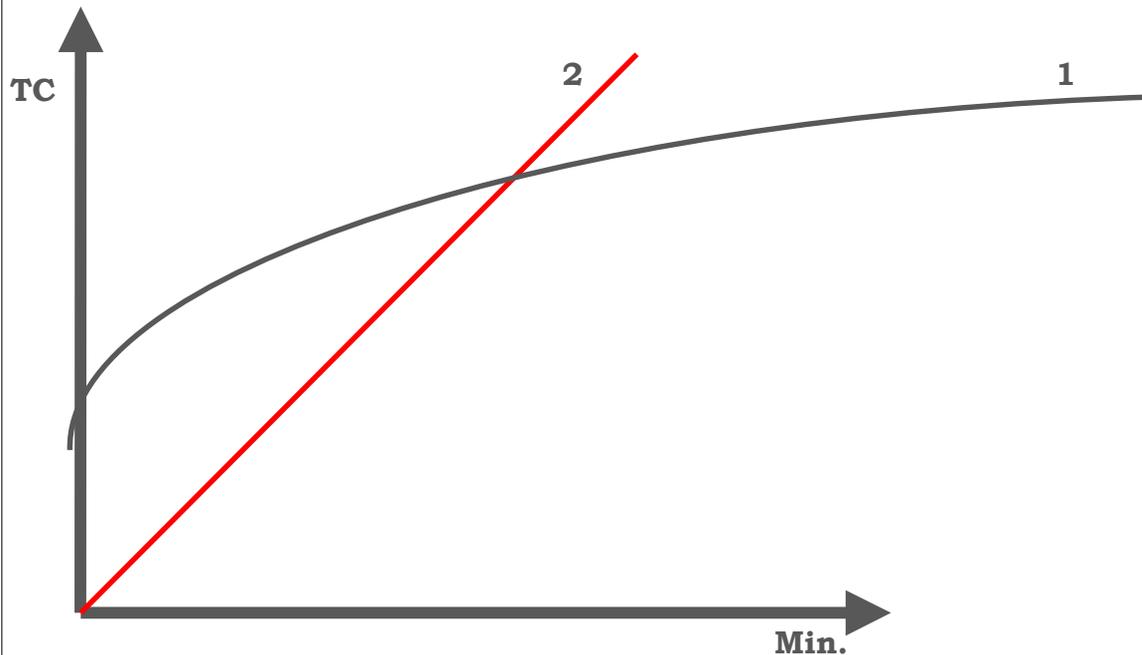


Price Distortions: NARROWBAND (5)

•To manage voice traffic of final clients a telco operator (typically an OLO) can choose between two models:

1) Fixed cost investment (ULL) + variable costs (interconnection for call termination)

2) Variable costs (interconnection for call origination) + variable costs (interconnection for call termination)



•The higher the relative price (P_{CO}/P_{ULL}), the stronger the incentive to invest in ULL

•With an appropriate mechanism of **Network Cap**, it is possible to guarantee a reduction of total costs and a change in relative prices in favour of ULL

Price Distortions: NARROWBAND (6)

REMEDIES

- Operational Separation between wholesale and retail divisions
- Elimination of Price-Cap mechanism at retail level
- Introduction of a Network Cap alongside market liberalization

Price Distortions: BROADBAND

BROADBAND is an emerging market

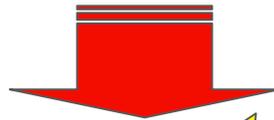


No regulation at costs but behavioural obligations



One way to assess abuse of SMP is a MARGIN SQUEEZE TEST

On 4th of July, Frontiers Economics presented in Bruxelles an analysis requested by Telecom Italia on methodology to check the existence of *Price Squeeze*



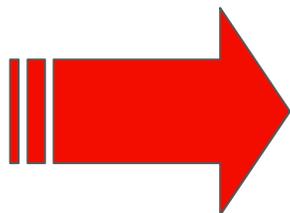
It is time to reach a consensus on the methodology

The true question is: WHICH IS THE PROPER UPSTREAM MARKET?

The EC Working Document, defining the wholesale local access market for the purpose of providing BB internet services, identifies a specific market segment: unbundled access (including shared access) to metallic loops and sub-loops

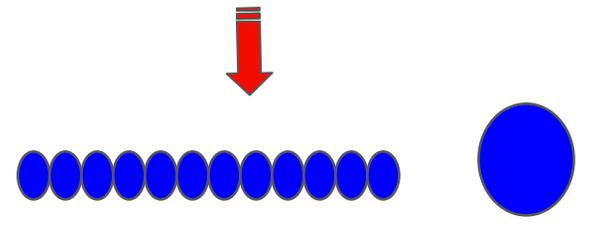
TODAY

Upstream market = High Speed Bit Stream Access (in Italy, CVP and ADSL wholesale)

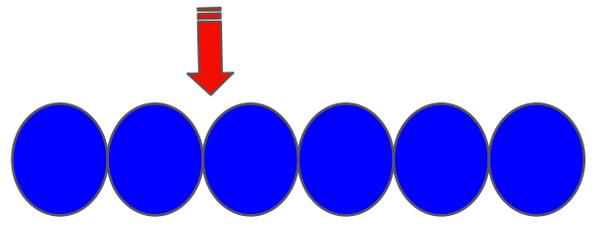


TOMORROW

Upstream market = Shared Access as wholesale offer for the definition of the price squeeze of BB retail offers



MARKET STRUCTURE:
One leader + many followers



MARKET STRUCTURE:
Peer market

Price Distortions: BROADBAND (3)

- It is necessary to set a deadline for current wholesale offers (sunset clause)
- With no deadline, OLOs will continue to behave as followers



No REGULATORY OBLIGATIONS on high speed bit stream access



ADVANTAGES

- Independence of OLOs in setting their strategies and technologies
- Increase in consumers' welfare (more offers on the market)
- Technological innovation + new investments cycle (infrastructures competition)

Price Distortions: BROADBAND (4)

REMEDIES

- Operational Separation between wholesale and retail divisions
- Regulation only on essential facilities
- Sunset clause on current wholesale offers
- Analysis of pricing behaviour through Price Squeeze Test
- Improving access to contents for Telco operators which provide broadband network services