Technical panel 2

Price distortions

LLU hearing
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DG Competition
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.
Aim of this panel

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

Buddha
Definition

◆ Price squeeze occurs where the difference between retail and wholesale prices does not suffice to cover the incremental downstream cost of providing that service and to generate an acceptable contribution to the profits over a reasonable time horizon.
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).
How to apply the price squeeze test

Retail price offered by dominant operator

Incremental cost

Downstream incremental costs incurred by dominant operator

Price of upstream (wholesale) component charged to competitors

Common fixed costs

Specific fixed costs

Variable costs

ULL tariffs

Napier Brown / British Sugar
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)
Input used for single product

Price X
backhaul

Price Y
Shared Use

Price Y'
Wholesale ADSL

Price Z
retail xDSL

_available prices incumbent for access at different stages_

What is the margin left?
Input used for more products

1: comparison product per product

2: averaging

Price X

Price Y²

Full unbundling

Wholesale voice

ISDN

ADSL

Different prices

Voice

ISDN

xDSL

Different prices

backhaul
Single product approach

- Retail price
- Inputs

- Customer management
- Customer acquisition
- Labour costs broadband operations
- Cost of BAS per line
- Cost of DSLAM per line
- Full unbundled loop
- ADSL for residential customers
- Monthly rental telephone line
The basket approach (1)
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: \( \text{retail price} = \text{weighted average of the prices of the various retail services supplied by the dominant operator} \)
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

Retail price

Inputs
“To avoid criticism, do nothing, say nothing, and be nothing.”

Elbert Hubbard
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