Averaging vs. De-averaging

A report prepared by Marsden Jacob Associates for the Competitive Carriers Coalition

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1. Introduction and summary

Marsden Jacob Associates (MJA) has been requested by the Competitive Carriers Coalition (CCC) to comment on the averaging / de-averaging discussion contained in the Telstra Undertaking. Our terms of reference are to discuss:

- the pro and cons of averaging and de-averaging;
- issues related to the inconsistencies between the structure of retail and wholesale prices;
- the relevance of the European experience; and
- the likely effects of moving from de-averaging to averaging.

The comments and opinions expressed in this paper are those of MJA and do not necessarily reflect those of the CCC. No part of this submission is confidential to MJA.

Our main findings may be summarised as follows:

- Unconditioned local loop (ULL) prices should be de-averaged (or cost based) to ensure that distortions to the market are minimised. Averaging will bias the investment decision faced by entrants and discourage investment that would allow for more efficient supply of services in lower density areas and encourage inefficient investment in alternative infrastructure in high density areas;

- In terms of inconsistency between retail and wholesale prices, Telstra suggests that the principle of competitive neutrality is violated by the current regime. We find their reasoning misguided. We also note that inconsistencies between retail and wholesale prices are not uncommon and exist in other markets;

- While the European experience is inconclusive, the experience from the US clearly illustrates that geographical de-averaging is regarded as important and necessary in the provision of unbundled elements and this can be implemented on a large scale; and

- The move to averaged prices is anti-competitive and contrary to the intentions of regulation. In particular, a significant rise in the price of ULL in urban areas is not in the long-term interest of end users and the impact on competition in markets for downstream services is detrimental.
2. **Averaging / de-averaging**

2.1. **The case for de-averaging**

To geographically de-average the price of Unconditioned Local Loops (ULL) is fundamentally about creating the right incentive for operators to make efficient build/buy decisions, i.e.:

- *Incentive to buy*: Encourage the use of existing facilities of the incumbent operator where this is economically desirable, avoiding inefficient duplication of infrastructure costs by new entrants;
- *Incentive to build*: Encourage investment in new facilities where this is economically justified by:
  - new entrants investing in competing infrastructure; and
  - the incumbent upgrading and expanding its network.

When access charges are based on forward-looking economic costs (such as the Total Service Long Run Incremental Cost – TSLRIC standard) they do not distort the build/buy decision of entrants. Entrants will be encouraged to use existing facilities if, and only if, it is economically desirable to do so. Further, cost-based access charges will also retain investment incentives for incumbents to upgrade or extend the existing network when new technology is available.

When charges are based on TSLRIC, facilities-based competition is encouraged in those areas where it is efficient to have competing infrastructure, whereas service competition is encouraged in those areas where the investment in competing infrastructure is not efficient.¹

In terms of the local loop, costs will depend on a number of different factors, including:

- line density – the number of lines per square kilometre;
- geology, geography and climate – for example, terrain, soil type, depth to bedrock, vegetation and water levels;
- regulation – for example, local government requirements that lines be laid underground; and
- input costs – for example, cost of trenching.

¹ However, if parts of the access market cannot be expected to become competitive even in the long run, then (forward-looking) TSLRIC pricing may not be appropriate. Instead, it may be socially optimal to set ULL prices at the lowest possible price that still allows the incumbent to finance its activities, i.e. to efficiently operate and maintain the network and upgrade its investment where necessary. This is particularly relevant for ULL where current (forward-looking) costs are likely to exceed historic costs. We do not explore this issue further in this paper.
Differences in line density normally constitute the main reasons for differences in line cost. Local loop costs are linked to line density via the average length of access lines and the average cable size (number of cable pairs):

- the longer the length of the access line, the higher the cost; and
- the lower the average size of cables in the different parts of the access network, the higher the costs.  

Trenching costs are almost independent of the size of the cable. The cost of trenching per line therefore drops almost proportionally with the average number of cable pairs per cable.

In theory, every subscriber line will have a different cost and could therefore in principle have its own de-averaged price. However, to estimate the cost of each line would be impractical and difficult and would confer large administrative costs and burdens on both access provider and seeker. Further, a competitor is likely to enter a geographic subset of a national market with the intention of serving all or a substantial segment in that area, not just one or two customers. Consequently, some averaging of ULL prices would be unlikely to distort competitors’ build or buy decisions because the deviation, both positive and negative, between the averaged charge and the actual forward-looking costs is likely to be small and to some extent offsetting.

In our view, the four different cost bands used by the ACCC represent a reasonable geographical segmentation and are aligned with international practice in this area.

2.2. The case against averaging

From a theoretical perspective, a price based on opportunity costs sends the right signal to consumers about the value of the resources the consumer/competitor/society is forgoing by using this service. Averaging means that, by definition, the charge will not

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2 The relationship between line cost and line density has previously been considered by the Productivity Commission (in August 2000).
3 A potential additional distortion to the build and buy decision is that the ULL charge will reflect the economies of scale (i.e. lower average costs as volume rises) that are enjoyed by the incumbent. These may not be available to new entrants over small volumes.
4 Band 1: CBD areas of Sydney, Melbourne, Brisbane, Adelaide and Perth; Band 2: urban areas of capital cities, metropolitan regions and large provincial centres (including other CBD areas not referred to above); Band 3: semi-urban areas including outer metropolitan and smaller provincial towns; Band 4 rural and remote areas.
5 Ideally, however, this could be tested by more detailed analysis of the competitive developments within each band.
6 Forward-looking cost is an opportunity cost concept in that costs and capital are valued on the basis of alternative economic cost.
correspond to the (opportunity) cost of ULL in areas where the ULL Service (ULLS) is purchased.

From an efficiency point of view averaged prices bear a risk of distorting investment decisions, causing inefficient bypass in low-cost areas and under-investment in high cost areas.

In lower density rural areas an averaged ULL price will be below efficient forward-looking costs. Entrants in rural areas will therefore to be inclined to rely on ULL, ignoring the true costs to society.7 Averaging therefore biases the investment decision faced by entrants and discourages investment that would allow for more efficient supply of services in those areas.8 In other words, averaging would have the effect of locking-in the options of broadband supply to Telstra’s copper-based network and outcome that cannot be regarded as competitive or efficient.

In high density urban areas, on the other hand, the ULL price, when prices are averaged, will be above efficient forward-looking costs. Entrants in city areas may therefore be more inclined to invest in their own access network in those areas even though, from society’s point of view, it would have been more efficient to rent the local loop from the incumbent. Hence, one outcome of averaging is that direct facilities-based competition is encouraged in more densely populated areas at the expense of service-based competition.9

Some may argue that such a development should be of less concern since the natural monopoly characteristics of the local loop are weaker in densely populated areas and that

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7 The costs to society differ from private costs. Private costs are those associated with a specific firm and those used by the business in their profit maximisation goals. The costs to society include the private costs but also that of society as a whole.

8 This is clearly acknowledged by Telstra in its response to the ACCC proposal - “A strategic review of the regulation of fixed network services”, 22 February 2006. In this paper Telstra critiques the stepping stone model, noting (footnote 51): Broad availability of network elements at prices below their true cost can distort the typical entrant’s investment decisions and cause it to lease the incumbent facilities rather than invest in its own technology. This can lead to an adverse effect on the variety of innovation services that are available to consumers. Regulation should not artificially promote competition or distort one form of competition based on access to incumbent facilities over facilities-based competition. Avoiding such distortion leads to the correct entry and investment signals being sent to new entrants (See Mark Armstrong and Davis E.M. Sappington, “Regulation, Competition and Liberalisation”, Mimeo, 2004, pages 19 and 34.)

We fully agree with this comment.

9 The expression facilities-based competition is commonly compared with services-based competition, in order to contrast the competitive situation where there are multiple operators each utilising their own network with one where a single network owner and one or more operators who re-sell services provided using the unique network. These cases are polar. There is a spectrum of modes of competition between “pure” facilities-based competition and pure resale. A service provider’s operations can be “facilities-based” notwithstanding that it does not own every part of the network it uses. Competition between an incumbent and another operator that uses its own facilities together with some unbundled elements of the incumbent’s network to provide services that likely differ from the incumbent’s services in their pricing and technical characteristics may also be characterised as facilities-based competition.
Averaging will encourage facilities-based competition in these areas (the long-term goal of regulation). However, such a line of thought does not fit well with an efficiency criterion, forcing market participants to base their investment decisions on signals that are not reflective of the true cost to society, thereby creating false conditions (from society’s perspective) for investment. The outcome of such false conditions is competition that is not sustainable in the long run. In particular, there is a risk that the incumbent over time can leverage on its true lower costs, reducing prices and ultimately forcing competitors whose infrastructure investment is less efficient (but who have been encouraged to enter because of a false higher price signal) out of the market.

Another problem of averaging arises when entrants can require incumbents to construct new lines and then subsequently rent them. In addition to biasing the investment decision of entrants, averaged prices may also remove the incentive for incumbents to rollout or to upgrade their network in high-cost low density areas where they would not able to recover their costs. More generally, averaging will in the long run limit the incumbent’s incentives to upgrade and maintain their network in those areas where rates are below cost.

To summarise, the main problem with averaging is that investment decisions are distorted. An averaged price sends a distorted signal and may encourage duplication where it is inefficient. This is particularly problematic when natural monopoly characteristics are pronounced and entry and duplication is inefficient - a situation which most likely reflects the realities of the Australian market.

2.3. The case for averaging

Setting averaged prices is simple and would be consistent with retail prices. If equity is the overriding criterion, above efficient pricing and creating conditions most conducive to sustainable competition, then this is a desirable outcome.

2.4. The case against de-averaging

Setting de-averaged prices is not an easy task and requires detailed cost modelling. Moreover, since retail prices in many cases to do not vary by region or geographical area, de-averaging of wholesale prices will result in a misalignment of retail and wholesale prices (of services using the same asset). In some cases this may make market entry difficult or even impossible. We discuss these issues in more detail in the next section.

10 Conversely, it could be argued that it may never be economical to duplicate the access infrastructure in rural areas and that the entrenchment of the ULL provider is appropriate.

11 See discussion in section 3.
3. Structure of prices

Telstra argues that de-averaged wholesale prices will cause problems in a world where retail prices are geographically averaged.\textsuperscript{12}

\textit{Telstra’s analysis of ULLS and the sustainability of cost recovery going forward, indicates that ULLS prices need to be averaged in order for Telstra to continue offering residential customers averaged retail prices, regardless of where those customers reside.}

While it is unclear exactly what Telstra is implying when they refer to sustainability and cost recovery going forward, we speculate that Telstra is referring to the situation where entrants engage in a form of arbitrage pricing, seeking out areas with artificially high competitive margins created by the relatively high averaged retail prices in densely populated areas with a relatively low cost-based ULL price. And by doing so, this reduces the margin Telstra is able to earn and its ability to cross-subsidise customers in rural areas. However, there are number of arguments that suggest that this line of argumentation is inappropriate.

First, if Telstra has a deficit from providing services in rural areas these costs should be recovered through the universal service mechanism that is already in place.

Second, as long as entrants are more efficient than the incumbent, such arbitrage is welfare enhancing. The main issue is that artificially high margins may encourage inefficient entry. However, as long as the wholesale ULL price is based on cost this will seek to eliminate inefficient entry.

Telstra argues that there is little prospect of ULL uptake in rural areas because Telstra’s retail prices are averaged and that this is inconsistent with the ACCC objective of promoting robust competition. We agree that the prospects of market entry in rural areas are limited without Government assistance through, for example, subsidies. However, these barriers to entry would exist regardless of the current pricing structures. Usage is typically low and costs high in rural areas. It may even be the case that usage and costs are such that it never would be commercially viable to provide services to a particular rural end-user. Even with averaged wholesale prices it is unclear that entry would occur. If it did we would expect it to be based on ULL not alternative infrastructure because the price signal is averaged. By suggesting an average ULL price, Telstra is implicitly attempting to make a policy decision to encourage service competition in rural areas. The opposite is true in urban areas, i.e. service competition in urban areas would be reduced. Indeed, in urban areas the suggestions by Telstra could, as a worst case scenario, leave

\textsuperscript{12} Telstra main submission in support of the ULLS monthly charges Undertaking, December 2005, p. 31
most competitive operators in a ‘blind spot’, i.e. with an averaged price that is too high to make it commercially viable to use ULLS and too low to promote alternative infrastructure competition.

From a purest economic view, unbundling should be de-averaged regardless of retail prices being averaged. To the extent that retail price structures are inconsistent with unbundled cost based prices, retail charges should be restructured to make them consistent with ULL prices. In other words, any inconsistency should be resolved in favour of moving retail prices toward cost levels, not by introducing distortions in the pricing of ULLS. Such a move is likely to be difficult from a political perspective. In particular, we note a recent Determination that will require Telstra to offer a basic retail line rental service at the same price across Australia and that Telstra will not be permitted to charge more than 22 cents for local calls offered with this service.

With a high degree of political interest in the industry, any increase in prices in rural areas is likely to encounter significant resistance. However, this issue may be countered by putting in place a subsidy scheme or targeted scheme for rural areas.

Telstra suggests that the principle of competitive neutrality is violated by the current regime (based on the inconsistency between retail and wholesale prices). While we agree that there are aspects of the current framework that are incompatible with a concept of competitive neutrality, Telstra’s reasoning in relation to long-run competitive neutrality is misguided.

Telstra correctly states that long-run competitive neutrality requires that:

\[ (1) \text{ equally efficient firms have the same opportunity to recover their total costs, and that (2) equally efficient access seekers and access providers are neither advantaged or disadvantaged in their respective roles in making} \]

13 Such an approach may also have the advantage of making the appropriate design of access charges easier. As noted by Mark Armstrong and Davis E.M. Sappington, “Regulation, Competition and Liberalisation”, Mimeo, 2004, p 44: In settings where a regulator has limited information and limited powers, the design of access charges can present extremely challenging problems. However, these problems can be mitigated if the incumbent VIP’s [vertically integrated producer] retail tariffs reflect its production costs... When retail rates reflect costs ... in the simple setting considered here, the ECPR .... collapses to a particularly simple rule: the access charge should be set equal to the VIP’s cost of providing access... this policy can require little knowledge of consumer demand, and does not require the regulator to be able to control the activities of entrants. In sum, an effective rebalancing of the incumbent VIP’s retail tariff greatly simplifies the regulator’s task of setting appropriate access charges, and allows access charges to focus on the single task of ensuring appropriate make-or-buy decisions.

14 The Determination makes clear that the price for the basic line rental service to residential customers will remain frozen at its level on 31 December 2005 of $31.95 until 30 June 2007, and thereafter only increase at the rate of inflation, see [viewed 20 March]:


15 Telstra main submission in support of the ULLS monthly charges Undertaking, December 2005, p. 33
market entry/exit and investment decisions. This in turn ensures that the most efficient provider prevails in the market, meaning that services are provided at the lowest resource cost to society.

As stated in section 2, this is exactly the outcome of cost-based pricing of the ULL, where correct economic signals are sent to the market. That there are inconsistencies between retail and wholesale pricing is a second order issue that could be solved (if it is material) by other means as noted above. Contrary to Telstra’s belief, setting averaged prices would not be competitively neutral. As we discuss in section 5, such a move would confer an immediate competitive advantage to Telstra and will clearly be incompatible with competitive neutrality in the long run because of the distortions in pricing signals.

Finally, we note that inconsistencies between retail and wholesale prices are not uncommon and exist in other markets. For example, Telstra offers geographically de-averaged PSTN Originating and Terminating (O/T) access service charges that are also separated into flagfall and end-minute-of-use charges. However, retail tariffs in the domestic long-distance market bear little resemblance to these prices. The ACCC also considers that the market for domestic long-distance call services is showing encouraging signs of competition.\textsuperscript{16} Hence a divergence between the costing and pricing of retail and wholesale services does not necessarily inhibit competition or lead to inferior outcomes.

\textsuperscript{16} Review of Telstra’s price control arrangements — an ACCC report, February 2005
4. **International experience**\(^{17}\)

4.1. **Europe**

In a media release to the Australian Stock Exchange, Telstra refers to Ofcom in the UK and ARCEP in France on the issue of geographically de-averaged prices for ULL. Comments from both regulators suggest that (non-geographic) averaging is a position generally adopted by European regulators.

We agree that averaging is common and widely used within the European Union (EU). To our knowledge the only member state that has geographical de-averaging is Finland.

As noted in section 2, a key rationale for recommending cost based for wholesale access is that prices based on forward-looking economic costs will send the correct investment signals to the incumbent and new entrants, when choosing between building and buying network capacity. Hence, the focus is on ensuring long-run efficiency.

For end-user charges, Article 3.1 of the Universal Directive relating to the availability of universal service emphasises:\(^{18}\)

> Member States shall ensure that the services set out in this Chapter are made available at the quality specified to all end-users in their territory, independently of geographical location, and, in the light of specific national conditions, at an affordable price.

The objective of affordability can therefore not be ignored. According to Article 9.4:

> Member States may require ... common tariffs, including geographic averaging ...

Geographic averaging is an option, there is no legal requirement that prices be geographically averaged for universal service.

In the past, some European countries have directly prohibited geographically de-averaged prices. These restrictions were abandoned when the countries aligned their regulatory regimes. However, some restrictions still exist. An example is BT in the UK. BT must supply universal services (basic local telephony) at nationally averaged prices. By

\(^{17}\) We do not provide a comprehensive international comparison. Instead, we have limited our analysis to Europe and North America.

\(^{18}\) Directive 2002/22/EC on Universal Service and Users’ Rights relating to Electronic Communications Networks and Services. Available at [viewed 23 February]:

contrast, there is no prohibition on geographic de-averaging of universal services in countries like Sweden, the Netherlands or Germany.

In its recent Strategic Review Phase 2 Consultation, Ofcom has indicated that it is prepared to consider taking a de-averaged approach to market definition and, therefore, to pricing for services outside the scope of the Universal Service Obligation.\textsuperscript{19}

As telecoms markets and as regulatory solutions develop, different geographical areas may experience different competitive conditions. Some areas already have a higher concentration of alternative infrastructure than others. In some areas, it is much more costly to supply customers than in others.\ldots [Ofcom identifies circumstances in which] it would be appropriate to define different markets in different geographies, or apply different remedies to different areas within a nationally-defined market.

In 2000, the European Commission (EC) published a working document on the unbundled access to the local loop. In this document, the EC was reluctant to provide any firm recommendations on whether averaging or de-averaging of ULL prices should be adopted. The EC reach the conclusion that it would be:\textsuperscript{20}

...inappropriate to issue at a European level a specific recommendation on geographic averaging or de-averaging of the price of unbundled local loops.

This conclusion is not surprising given that there are both advantages and disadvantages (as discussed in previous sections) from both a policy and economic perspective of the different pricing regimes and that the magnitude of these are likely to vary significantly between Member States.\textsuperscript{21}

\begin{footnotesize}
\begin{itemize}
\item [\textsuperscript{19}] Ofcom Strategic Review, Phase 2 Consultation, 18 November, 2004, para 5.10. Available at [viewed 20 March]:
\url{http://www.ofcom.org.uk/consult/condocs/telecoms_p2/tsrphase2/maincondoc.pdf}
\item [\textsuperscript{20}] European Commission (2000): Working Document of DG13 (INFSO) A1 on "Unbundled access to the local loop", 9 February 2000. Section 2.1.3.1. Available at [viewed 30 February]:
\url{http://europa.eu.int/comm/information_society/policy/telecom/localloop/pdf/working_en.pdf}
\item [\textsuperscript{21}] The EC’s discussion may be summarised as follows:
\begin{quote}
The advantage of setting different prices which reflect geographical differences is that prices would more closely reflect costs and therefore give more appropriate signals for investment. On the other hand … retail prices would be likely to vary by region and this would be a departure in many cases from the way retail prices of services supplied by the incumbent are currently set.

Conversely, setting nationally averaged wholesale prices for unbundled local loops would be simpler and would be likely to produce retail prices at common levels. However, setting prices that are not related to costs is likely to create distortions....
\end{quote}
\end{itemize}
\end{footnotesize}
4.2. USA

With respect to the pricing of Unbundled Network Elements (UNEs)\(^{22}\), the Telecommunications Act of 1996 is clear in that it requires that prices be “based on the cost” of providing the network element.\(^{23}\)

The notion that access prices should differ depending on the local circumstances is well documented in US regulatory history. In the First Report and Order on local interconnection, the Federal Communications Commission (FCC) determined that UNE rates be geographically de-averaged\(^{24}\) to meet the 1996 Act’s mandate that charges for interconnection and unbundled elements be:\(^{25}\)

\[
\text{based on the cost . . . of providing the interconnection of network elements.}
\]

After surveying the state Public Utility Commissions’ different costing methods for geographically de-averaged zones, the FCC concluded that:\(^{26}\)

\[
\ldots \text{three zones are presumptively sufficient to reflect geographic cost differences in setting rates for interconnection and unbundled elements, and that states may, but need not, use these existing density-related rate zones. Where such systems are not in existence, states shall create a minimum of three cost-related rate zones to implement deaveraged rates for interconnection and unbundled elements. A state may establish more than three zones where cost differences in geographic regions are such that it finds that additional zones are needed to adequately reflect the costs of interconnection and access to unbundled elements.}
\]

The FCC therefore also recognised that UNE costs must be assessed in light of the different geographical conditions. The result was that the majority of American states established three density-based zones for access pricing.\(^{27}\)

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\(^{22}\) In the United States unbundled network elements (UNEs) are distinct parts (or elements) of the telephone network, such as the copper loop, port, switching, transport facilities and other network facilities. The recombination of UNEs into a complete stand-alone telephone service is referred to as a UNE-P (unbundled network element platform).

\(^{23}\) Note that the UNE platform is currently in the midst of a transition.


\(^{26}\) See supra note 24, para 765.
4.3. Discussion

In our view, the lack of specific guidance in this area by the EC illustrates that specific consideration of the market to which the prices will apply is necessary. Although we have not been able to analyse in detail the reasons underlying the decisions by each Member State in their determination of averaged ULL prices, it would seem that these decisions are rooted in:

- historical pricing decisions in the retail market;
- the complexity of calculating de-averaged costs; and
- the relative geographic homogeneous nature of some of the member states.

On the last point we note that Australia is vastly different and more diverse than that of any one European country. Large parts of Australia have unusual characteristics in terms of density and population leading to cost structure that is very different than that in other countries. This is illustrated in the figure below.

**FIGURE 1: A COMPARISON OF COST STRUCTURES**

![Figure 1: A Comparison of Cost Structures](image)

Source: MJA

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27 For a survey of the different UNE prices, see *A Survey of Unbundled Network Element Prices in the United States* (August 2005). This survey is compiled by Billy Jack Gregg, Consumer Advocate, West Virginia PSC. It consists of an introduction and a spreadsheet in XLS or PDF format with pricing information. Available at [viewed 23 February]:

With “X” number of subscribers, the particular market illustrated above would be a monopoly in Australia but not in the EU, where there would be room for two operators.28

This makes it relatively more important to focus on sending the correct economic signals in order to encourage efficient investment and in particular to encourage investment in alternative technologies in rural areas where copper-based services are likely to be less efficient. As stated previously this is done through de-averaged ULL prices.

Experience from the US clearly illustrates that geographical de-averaging is regarded as important and necessary in the provision of unbundled elements and this can be implemented on a large scale. The US experience also illustrates the importance attached to setting wholesale prices that reflect the underlying costs.

While the US experience clearly reinforces the current practice of de-averaging ULL, the European experience is inconclusive from the perspective of the regulatory guidelines, but does provide support for averaging in terms of implementation. Regardless of these observations, it is our view that a decision on averaging or de-averaging must have a clear founding in the realities of Australian cost structures and precedents and cannot simply import decisions from other jurisdictions.

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28 Note that the figure is only an illustration and is simplified in that different areas of Australia (and to a much lesser extent the EU) will exhibit different cost structures. In particular, cost structures in major urban areas are likely to resemble those in Europe.
5. **A move from de-averaging to averaging**

In the following we discuss the move from de-averaging to averaging from the perspective of Telstra and its competitors.

### 5.1. Telstra

The majority of ULLs are today found in urban areas. Since the de-averaged price is lower in urban areas than in rural areas, an immediate shift to averaged prices would confer on Telstra a substantial windfall gain: the revenue generated from ULL would rise because those areas where ULL is used would see the price of ULL rise. In addition, removing de-averaging would also provide Telstra with some immediate artificial protection from being displaced by a more efficient access seeker who is active in providing downstream retail services.

At the same time Telstra’s costs would remain unchanged and hence would achieve a competitive advantage. If access seekers chose to increase their downstream retail price to compensate for their margin loss, Telstra could either follow suit and recover extra rents, or keep its own pricing unchanged. In this way, Telstra is able to undercut its competitors and capture greater market share. Alternatively, access seekers could accept a margin squeeze. In this case Telstra would have a potential competitive advantage in any other market in which both Telstra and access seekers compete.

To summarise, a move to averaged prices confers on Telstra an immediate wind fall gain, but also a competitive advantage.

### 5.2. Competitors

Entrants have built their business cases under the assumption that price will remain de-averaged (at least in the short to medium run). Any sudden changes to regulatory sentiment would therefore cause serious disruption in the market.

Averaging of the ULL price may force some access seekers to pass on increased costs to end users, face a squeeze on their margins or ultimately exit the market if competitive margins are completely eroded.

A rise in the ULL price can be regarded as in increase in productions costs, i.e. it costs more to produce the same services. Without any compensating changes in the retail price the profit margin of the entrant is reduced or even removed. Further, even if an entrant is
able to retain a positive margin, higher input costs are likely to reduce the chance of
long-term success in a market, as price manoeuvrability is reduced.

5.3. Conclusion

Entrants have invested large amounts in ULL based on a defined regulatory regime. A
move towards averaged ULL prices will change the market dynamics to the detriment of
ULL operators who could end up with stranded investments. The only beneficiary is
Telstra. The move to averaged prices is anti-competitive and contrary to the intentions of
regulation. In particular a significant rise in the price of ULL in urban areas is not in the
long-term interest of end users and the impact on competition in markets for downstream
services is likely to be detrimental.