Economuse, 25 May 2007

The umpire’s decision – a bit average?

The Competition Tribunal’s refusal of Telstra’s appeal against de-averaged pricing of unbundled local loop is not as clear-cut as the headlines suggest. All seven findings against Telstra are about the level and not the structure of prices.

Telstra wanted the Tribunal (ACT) to bring the “rogue regulator” (ACCC) to heel. Specifically, it believes that the average retail pricing forced on it by its price control obligations should be mirrored in averaged loop (ULLS) pricing. The decision published on Monday came close to agreeing on a close reading of the arguments [1].

The case for averaging
The ACT seems very sympathetic to the arguments for averaged pricing: “we consider averaging could be in Telstra’s legitimate business interests even if there existed above normal profits from the provision of other CAN services.” [para 248]. And, it accepted that price controls were a real constraint on Telstra [paras 207, 217-224]. And, while it accepted that current ULLS prices in urban areas would increase with averaging, it argued that efficient access-seekers should still be able to compete with Telstra [paras 109-113]. So, why did it not endorse averaging?

Competition
Part of the answer lies in the interpretation of “promoting competition”. The ACT has traditionally viewed competition as more important than competitors. I think it is peeved that the 2006 amendment to s 44H(4)(a) of the Trade Practices Act replaced “would promote competition” with “promote a material increase in competition”. Hence the comment: “Averaging may not inhibit the ability of efficient access seekers to compete with Telstra in retail markets, but that does not mean it enhances their ability to compete” [para 116].

Telstra’s argument is actually that it would provide the increased competition if the cream-skimming between de-averaged UULS prices and averaged retail prices could be eliminated in urban areas. On the ACT’s “analysis” [paras 121-126], Telstra will continue to compete in urban areas despite an erosion of the cross-subsidy to rural areas.

However, this conclusion is contradicted by further analysis [paras 199-203] comparing the two options open to Telstra: lower urban retail prices towards de-averaged costs to match competitors or refrain from competing in urban areas by holding prices. Here, it concludes that “neither strategy would, in principle, enable Telstra to meet both its price caps and earn sufficient revenues to cover costs in a way that would be consistent with meeting its legitimate business interests”.

Telstra also argued that there would be increased infrastructure and service based competition in urban and rural areas respectively as a result of averaging. The ACT notes that the former may result in by-pass of ULLS but that this risk "did not totally undermine" Telstra's case for averaging [paras 78, 82 and 255]. And, while it is true that averaged ULLS pricing would deter rural investment in WiMAX [para 155] it should increase the incentives for alternative infrastructure in urban areas where the biggest markets lie.

The ACT observes that "Telstra might be able to set prices for retail line rental in urban areas below those which an access seeker might charge if ULLS charges were averaged" [para 114]. But isn't anti-competitive behaviour controlled (eg by imputing wholesale charges)? It is irrelevant to setting access prices.

Efficiency versus equity

Everyone agrees that averaged prices are not allocatively efficient and result from retail price controls [para 173]. The ACT acknowledged that it can have regard to government equity objectives "if relevant" but dismisses the equity objective because it does not support the efficiency objectives! A Ministerial Direction to the ACCC on averaging would settle this conflict between equity and efficiency differently.

Optus argued that the Universal Service Fund (USF) is the appropriate vehicle for compensating Telstra for any losses it incurs in providing retail services at below-cost prices in rural areas [para 226]. But, the ACT suggests that Telstra has a case in arguing that the USF, set by Ministerial fiat without reference to costs, does not provide such compensation and Telstra could then seek to "match its revenue to the efficient forward-looking costs of providing the ULLS in both urban and rural areas by averaging" [paras 227-232].

John de Ridder is a consulting telecommunications economist with expertise in competition, pricing and regulation. www.deridder.com.au

[1] The statement is at http://www.austlii.edu.au/au/cases/cth/ACompT/2007/3.html