“The product of an arithmetical computation is the answer to an equation: it is not a solution to a problem”

- TS[E]LRIC: Ashley-Perry’s Axioms, Not Busyly At Work

Michael Bepristis
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Outline

1. Introduction
2. ECPR
3. Local-cap
4. FCC’s TSLRIC
5. BT’s Price-cap

Introduction

• What is interconnection
• Interconnection Goals
• Why is Access Pricing Important
• Interconnection Specific Issue

INTRODUCTION:

What is Interconnection?

• Intermediate good of monopolist used in competitive markets
• TCG terminating calls to NYNEX customers
**Introduction:**

**Interconnection Goals -**

- Encourage competitive entry
- Avoid inefficient bypass
- Promote a competitive market transition
- Maintain incentives for incumbent to upgrade and expand network

**Why is Access Pricing Important?**

- Mono-polist rents
- Efficient entry excluded
- Monopolist losses
- Inefficient entry

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**Interconnection Specific Issues -**

- Accurate determination of cost/ price
  - 16 access pricing proposals
  - MC - AIC - Joint - Common...
- Privatization and Liberalization
  - Telefonica and EU
  - Telkom (Indonesia)
  - RBOC’s
ECPR:

Model -

Direct cost of access + opportunity cost

\[ \text{ECPR} = \text{AIC}_{a-b} + \text{opportunity cost} = 5 + 3 = 8 \]

Strengths and Limitations -

- Strengths
  - Efficient entry
  - First best pricing
- Limitations
  - Contestability
  - Monopoly rents/ inefficiencies
  - Demand expansion

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Local-cap:

Model -

Control access price through toll price

\[ I_{\text{comp}} = \text{Monopolists interconnection revenue} \]
\[ P_{ld} = \text{Monopolists price for long distance} \]
Local-cap:

Strength and Limitations -

• Strengths
  • Exogenous variable as price control
  • Reduced information/ regulatory demands

• Limitations
  • Local and Toll markets
  • Correlation between toll and access
  • Which toll and access prices

Outline:

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TSLRIC:

Model -

Total Service Long Run Incremental Cost

• General Structure (Hatfield, CPM, BCM)
  • Underlying cost/demand structure
  • Network Investment
  • Investment Considerations

TSLRIC:

Strength and Limitations -

• Strengths
  • Transparency
  • Long-run “ensures” efficiency

• Limitations
  • Model vs. reality
  • Which technologies to cost
  • Determination of “economic life”
Introduction

ECPR
Local-cap
FCC’s TSLRIC
BT’s Price-cap

Price-cap:

Model -

Service baskets of varying competitiveness

<table>
<thead>
<tr>
<th>Service Basket</th>
<th>Price-cap</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Prospectively</td>
<td>RPI+0%</td>
<td>-</td>
</tr>
<tr>
<td>Call Termination</td>
<td>RPI-X</td>
<td>LRIC</td>
</tr>
</tbody>
</table>

Strength and Limitations

• Strengths
  • Transparency
  • Minimal regulatory footprint

• Limitations
  • Determination of X and RPI
  • Determination of effective competition
  • Initial year and common cost allocation

Conclusion -

• Complexity of environment
• Informationally demanding
• Information Asymmetry
• Dramatic Consequences
“[I]t would be desirable to abandon the word ‘valuation’ -- since that word misleadingly connotes some moderately rational judgment -- and to substitute some neutral term, devoid of misleading associations, such as ‘aluation,’ or, perhaps better still, ‘woosh-woosh’.”

- Hon. Jud. Jerome