



Australian Competition and Consumer Commission

**Submission in response to the DBCDE Discussion Paper:
*Implementation of Universal Service Policy for transition to the
National Broadband Network environment***

November 2010

1. Introduction

The ACCC welcomes this opportunity to provide comments on the implementation of the Universal Service Policy (USP)¹ for the transition to the National Broadband Network (NBN) environment. The delivery of telecommunications services under the USP clearly has implications for the delivery and competitiveness of communications services.² Although the ACCC will not have a direct role in administering the USP, it does have responsibility for regulation of competition and communications infrastructure under the *Trade Practices Act 1974* (the TPA). The USP necessarily interacts with these functions in a number of ways.

The ACCC supports the objectives set out in section 1.3 of the *Implementation of Universal Service Policy for the transition to the National Broadband Network environment – Discussion Paper* (Discussion Paper), in particular, the opportunities and incentives for industry to minimise government intervention in the provision of accessible telecommunications services. The delivery of services to end-users for whom the costs of service provision exceed the revenues that can be earned (so-called ‘uneconomic’ services) should be undertaken as efficiently as possible, whether they be services provided under the universal service framework, or services provided over the NBN.

The ACCC is also of the view that, as a general principle, the sources and use of funding to support the provision of these uneconomic services should be as transparent and non-distortionary to competition and efficiency as possible. The funds received from any relevant levies should be provided in a targeted manner and only towards those services that genuinely require subsidisation. In this regard, the ACCC has previously expressed a preference for funding uneconomic services through external funding mechanisms, as opposed to internal cross-subsidies, in its submission to DCITA’s 2007 review of the universal service obligation,³ its report to the NBN Expert Panel in 2009⁴ and its submission to DBCDE’s 2009 regulatory reform review.⁵

Given the short consultation period, the ACCC has only provided brief comments on the Discussion Paper. As noted in Chapter 2 of the Discussion Paper, any future legislative and/or regulatory process will include appropriate consultation with stakeholders. The ACCC welcomes the opportunity to comment further on any specific proposals put forward by government relating to the USP.

The ACCC also notes the parallels between the funding of the provision of the standard telephone service (STS) under the USO and the ACCC and NBN Co’s current consultation process on the location of points of interconnect (POIs) to the

¹ The ACCC notes the distinction between the USP and the Universal Service Obligation (USO). The current USO regime is set out in detail in the Discussion Paper at Chapter 3.1.

² In November 2007 the ACCC made a submission to the DCITA review of the universal service obligation (USO).

³ ACCC, *Submission to the DCITA review of the universal service obligation (USO)*, November 2007

⁴ ACCC, *Assessment of Proposals, National Broadband Network Process: Report to Expert Panel, Public Version*, January 2009, Appendix E.

⁵ ACCC, *Submission to the Department of Broadband, Communications and the Digital Economy, National Broadband Network: Regulatory Reform for 21st Century Broadband*, June 2009, section 3.1.

NBN.⁶ Although funding for the USO is aimed at reducing the barriers to service provision posed by the potentially high costs in supplying a STS, the high cost of backhaul to some regions poses a barrier to providing telecommunications services to end-users in these regions. Without a mechanism for reducing the price of backhaul and funding any subsequent losses incurred in supplying backhaul services, this barrier could persist into the NBN world. These matters have been highlighted by the ACCC for stakeholder comment as part of the POI consultation process and will be considered more fully in light of submissions to that process.

The ACCC has provided its comments broadly in line with the structure of the Discussion Paper.

2. Universal Service Policy

The Discussion Paper is focused on the implementation of the USP, principally through the establishment of a new entity, USO Co, which will commence operation in July 2012. USO Co will be responsible for delivering the government's public policy objectives in the telecommunications sector, including a number of responsibilities that go beyond the provision of a standard telephone service (STS). These include emergency call handling, the national relay service, and the development of technological solutions for continuity of public interest services such as public alarm systems and traffic lights.

The ACCC notes that the range of issues identified by the Discussion Paper as part of the USP is a broader than the issues collectively referred to as the USO. Clearly identifying the parameters of the USP is a critical step in the development and implementation of universal services in telecommunications.

The ACCC has restricted its comments to those issues that have implications for future competition in the telecommunications and associated industries.

These issues include:

- Arrangements for the delivery of voice telephony in non-fibre areas
- The costing of voice services under the USP
- Arrangements for migrating voice only customers and services
- Funding arrangements for USO Co

⁶ ACCC, *National Broadband Network Points of Interconnect – An ACCC Discussion Paper on points of interconnect to the National Broadband Network*, October 2010

3. Arrangements for voice telephony

3.1 Delivery in non-fibre zones

Chapter 3.1 of the Discussion Paper indicates that the government will be entering into arrangements with Telstra for the maintenance of its copper network and delivery of certain services following the commencement of USO Co. It is critical that the exact nature and scope of the services to be provided by Telstra are clearly defined, particularly with regards to the provision of a STS to premises not served by NBN Co's fibre network. The precise definition of such services has a number of advantages, including much greater certainty regarding the services to be offered in any future competitive tender process. It will also facilitate much greater accuracy in the costing of services and reduce the risk of disputation between USO Co and a service provider.

The Discussion paper seems to indicate that Telstra could continue to provide retail services using its copper network outside the fibre footprint until 2022.⁷

3.2 Flexibility in service delivery

The current USO regime gives the Primary Universal Service Provider the ability to define the ways in which it will meet its obligation and, to a degree, the scope of that obligation. For example, the standard telephone component of the USO is currently defined as the obligation 'to ensure that standard telephone services are reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business'.⁸ Under these arrangements, many of the key characteristics of the USO, such as functionality of the STS, reasonable access and pricing parity, are left to be defined by Telstra in its USO Standard Marketing Plan and USO Policy Statement. It is the view of the ACCC that any USP should be technology neutral where possible.

3.3 Determining Costs

As noted in the ACCC's submission to the DCITA review of the USO in 2007 (2007 submission), it is difficult to evaluate the true cost of providing universal service when the scope of the USO is not clearly defined. As such, there is no definitive answer on how many services are provided under the universal service arrangements, or where those services are located. This makes it very difficult to accurately determine a carrier's losses (if any) from providing universal services. Consequently there will always be scope for dispute.

The Discussion Paper seeks submissions on the appropriate methodology for determining funding costs for the purpose of the proposed arrangements between USO Co and Telstra.⁹ One of the options discussed is the possibility of using cost models developed by the ACCC for determining costs for the provision of voice services.

⁷ DBCDE, Discussion Paper, p9

⁸ *Telecommunications (Consumer Protection and Service Standards) Act 1999*, s. 9.

⁹ DBCDE, Discussion Paper, Q3.1(8) and Q3.1(9)

The ACCC undertakes cost modelling exercises as part of its responsibilities under Part XIC of the TPA. As noted in the Discussion Paper, the costing of legacy telecommunications networks has been a complex and often contentious process. The cost of providing access to basic telecommunications services is obviously a significant issue given that the government (via USO Co) proposes to enter into an agreement with Telstra for the provision of such services.

The ACCC's cost models for fixed line services are designed for the purposes of setting indicative prices for access to each of the declared fixed line services. These prices are not binding on the ACCC but help guide commercial access negotiations by providing greater certainty about the ACCC's views on reasonable access prices.

The ACCC's cost models can be categorised into two types:

(1) cost models which contain geographically disaggregated information, but include a degree of optimisation in the network design and as such are not based on actual cost, and

(2) cost models which are based on actual costs that are not geographically disaggregated.

Using either of these existing model types to calculate costs for the provision of USO services could prove difficult. However, the development of a model for the costing of USO services would be complementary to the ACCC's modelling exercises undertaken as part of its existing responsibilities. There are likely to be advantages in consistency between existing ACCC models and any future model(s) developed for the USO.

The development of a USO cost model would require detailed cost and revenue information on each service which has a USO attached to it. This information would need to be provided by Telstra.

3.4 Contestability of USO services

The ACCC's 2007 submission raised a number of issues relating to the introduction of contestability to the provision of universal service. It noted that the use of market mechanisms can:

- minimise the universal service subsidy by encouraging the provision of universal service over more efficient networks
- help to overcome the information asymmetry problems that arise when a regulatory body seeks to independently estimate costs
- help place a value on the intangible benefits that a carrier receives when it is the universal service provider
- allow the government and regulator to avoid the high cost of developing cost models

As noted in the Discussion Paper, the National Relay and Outreach Service are already sourced through a competitive market process. The paper also indicates that

the USO Co may decide to initiate competitive processes for the provision of other public interest functions such as STS obligations and emergency call handling. The ACCC generally supports such a proposal.

The use of competitive tender processes is one possible method of using market forces to introduce contestability for the provision of universal services. As pointed out in the 2007 submission, a government tender process could also be used as the basis for determining the level of universal service funding. The design of the tender, including the exact specification of the service to be provided, is crucial for a successful tender process.

The 2007 submission concluded that there are some practical difficulties associated with competitive tendering for the provision of services in areas where services are already being provided, given the incumbent provider's strong bargaining position and intricate knowledge of its customer base and existing sunk network. In any USO tendering process, the USO area would include both loss making and profitable customers with implicit cross subsidisation between them. Any potential bidder risked losing the profitable customers through competition and being left with only the unprofitable customers and insufficient USO subsidies to cover its costs. As a result of this risk, no carrier nominated to become a universal service provider under previous efforts to introduce universal service contestability in 2001.

An alternative mechanism for introducing market forces is through per service subsidies, limited to loss-making customers only. Operators would compete for customers and receive universal service subsidy payments based on the number of loss-making customers they serve. This approach would be assisted by clear definition of the scope or footprint of the USO which would allow loss making services to be individually identified.

4. Arrangements for Payphones, Emergency Call Handling, and National Relay Service

The ACCC does not have any comments on the issues raised in Chapters 3.2 to 3.4 of the Discussion paper at this stage, although it may submit on any future consultation. The ACCC notes that regulation of these areas is the responsibility of the Australian Communications and Media Authority (ACMA).

5. Arrangements for migrating voice-only customers to fibre

In chapter 3.5 the Discussion Paper proposes that USO Co would pay the migration costs (i.e. the costs of in-home wiring) for voice-only customers.

Question 3.5(4) recognises that this approach may create an incentive for people to adopt a voice-only service prior to migration and then connect to broadband after receiving the migration payment. Offering a subsidy for re-wiring to 'voice only' customers but not 'voice and broadband' customers could have implications for retail market competition which may need to be more fully thought through, and is likely to create the perverse incentives outlined in the discussion paper. More broadly, this proposal also raises equity issues. It may be advisable to means test any such payment (e.g. by paying it to pensioners and other low-income earners) rather than providing it on a 'services purchased' (i.e. 'voice only' versus 'not voice only') basis.

The ACCC notes that it is not necessary to re-wire an entire premise when migrating voice only customers to the NBN. The end-user can continue to use their STS with multiple connection points over the NBN with minimal intrusion and expense. To maintain the existing telephone(s) in current working order it will only be necessary to connect a copper cable from the telephone port on NBN Co's Network Termination Unit (NTU) to the first existing telephone socket. None of the existing wiring between multiple telephone sockets in the house will need to be modified.

The ACCC is of the view that any subsidy should only be provided to assist in the funding of the copper connection, and its installation, between the NBN Co NTU and the first existing telephone socket and possibly the provision of a battery for those customers for whom service continuity during power outages is essential (such as for medical reasons). This subsidy should be provided to the party that incurs the costs in undertaking this re-wiring or provides the battery.

6. Development of technological solutions for public interest services

The ACCC notes the expansion of the USP to include the development of technological solutions to maintain public interest services (such as traffic lights).

Chapter 3.6 raises some concerns as, depending on exactly how the arrangements are structured, Telstra may receive (or may be perceived to receive) a competitive advantage over other access seekers in relation to its ability to provide services over the NBN. This is because the research and development for the technological solutions required to replicate existing functionality will not go out to open tender, but will be undertaken by Telstra with funding via USO Co.

Although there will be a requirement that the output of such research is made available on an equitable basis, Telstra will inherently become better informed about how to deliver services using the NBN earlier than other access seekers (as presumably its employees will need to be given access and information in order to develop these solutions). It will also receive a 'reputational' benefit as the company which is charged with delivering solutions to these issues. Open tender would increase transparency and allow other businesses to compete to supply these services, which is likely to ensure that the services are provided at lowest cost.

This advantage could also be used to assist Telstra in developing solutions ahead of any other RSPs for other existing copper based technologies which would give it an advantage in competing in the delivery of those services in the retail or wholesale space (i.e. for corporate and government contracts).

7. Funding arrangements for USO Co

The problem of ascertaining the accurate cost of providing the universal services due to the lack of clarity about their footprint has been discussed earlier at 3.3. Funding those services is similarly problematic, because the requirements are not well defined.

The Discussion Paper acknowledges the distortionary impact of the current USO levy and raises some options for raising the levy, such as including other revenue sources and reviewing the annual revenue threshold. It proposes that the levy should be paid by retailers and wholesalers (including NBN Co). With the separation of wholesale

and retail functions after the NBN is rolled out, it may be appropriate to consider whether, in future, the levy should be imposed on wholesale service providers only. This would ensure all retailers are treated equally and reduce the administrative burden of collecting the levy.

As highlighted previously, the ACCC is of the view that the source and target of the funding required to support uneconomic service provision should be transparent and minimise distortions to competition and efficiency. Consistent with its position on these matters in the past, the ACCC recommends that any subsidisation of uneconomic services under the USO and USO Co framework should continue to be provided by an external funding mechanism.

The Discussion Paper asks whether responsibility for determining the levy amount should be transferred from ACMA to USO Co. Given that USO Co will be responsible for ensuring that the cost of providing USO services is minimised, it would be preferable, in terms of maximising incentives to minimise costs, to leave determination of the amount of the levy with an independent body. As noted in section 3.3, the ACCC frequently undertakes cost modelling exercises as part of its existing responsibilities. There are likely to be advantages in having consistency between existing ACCC processes and any new process applicable to USO Co.