

**Submission to the Department of  
Communications, Information  
Technology and the Arts**



**vodafone**

Vodafone Australia Limited ACN 056 161 043

**Telecommunications Universal Service Obligation (USO) Review  
Issues Paper**

**November 2007**

## Executive Summary

---

Vodafone welcomes the opportunity to comment on the design and operation of the telecommunications Universal Service Obligation (USO), specifically how the protections under the USO should operate in the future. Vodafone appreciates that the review has a broad focus and encourages comment on different approaches and models to best deliver these protections in a rapidly changing industry. It is in this context that we make our submission.

In summary, our submission addresses the following issues:

- the context of the current review;
- the focus of the USO – should it be narrowed or broadened;
- the USO as a consumer safety net;
- identifying those households that do not have access to metro-equivalent voice services;
- the delivery of the Standard Telephone Service (STS) under the USO;
- the role of the Customer Service Guarantee (CSG); and
- funding the USO scheme.

In addressing these issues, Vodafone submits the following:

- focusing the application of the USO is in the long-term interest of rural end-users, and is consistent with the Regional Telecommunications Inquiry (RTI) recommendations and the Government's policy framework<sup>1</sup>;
- the USO is a social policy construct and should be considered a consumer safety net – a guarantee that households have access to a basic telephone service where such services are not provided commercially;
- the Broadband Connect funding scheme means that the USO should only apply to the 1 per cent of households that are not to be covered by the OPEL network;
- the USO provider be limited to supplying only basic telephony, and ensure that USO funds are not used to cross-subsidise services in competitive markets, such as mobiles;
- the USO provider should be free to choose the most effective and efficient technology through which to provide the basic telephone service to 1 per cent of rural households;
- if the current USO system is retained, Vodafone strongly disagrees with any move to place an obligation on mobile or broadband service providers to provide services to all Australian households – or to extend the obligations beyond households to general coverage;
- the CSG should not be extended to networks that are competitively supplied;
- the CSG – or similar obligations – should be placed on the OPEL network. This will ensure that rural consumers are protected against substandard network service;
- as the USO is a social policy construct, the USO should be funded via consolidated revenue, possibly via general taxation – however it should not be funded by industry levies; and
- if the USO is to continue to be cost-recovered it must be recovered solely from Telstra – cost recovery theory dictates that it should be recovered from the beneficiary of the scheme.

---

<sup>1</sup> see *USO Review Issues Paper*, p.5.

## **The context of the current review**

---

The purpose of the USO is to enable all people in Australia, wherever they reside or carry on business, to have reasonable access on an equitable basis to:

- standard telephone services;
- payphones; and
- prescribed carriage services (none have been prescribed).

Vodafone notes that the purpose of the USO scheme is focused on households or places of business. It is not intended to apply beyond household connections to reasonable access to roaming coverage.

When the USO was designed, it was the only substantial mechanism through which the Government assisted regional and rural areas to have access to basic telephone services. Since then, however, several significant Government funding arrangements have assisted the development of mobile, satellite and broadband services.

Vodafone notes the comments from the 2002 Regional Telecommunications Inquiry that:

*The current USO approach was developed to underpin the supply of basic telephone services in a monopoly environment. It was premised on there being a single telephony provider who would internally cross-subsidise the cost of providing a limited range of services, regardless of location. While it has been carried over into the new competitive environment, experience suggests the model is poorly suited to an increasingly competitive market place, a wide range of products and diverse consumer demand. The USO, and the basic, minimum standard of service it provides for, now seems at odds with the rapidly expanding telecommunications needs of Australians. (p.207)*

Vodafone submits that the USO needs to be reviewed within the complete context of the Government's assistance for rural and regional telecommunication services, including:

- the telecommunications policy framework;
- the development of a competitive market as the primary strategy for delivering improved services and lower prices;
- a comprehensive set of regulatory safeguards for consumers; and
- targeted funding to support improvements in advanced services, particularly in rural and regional areas, where the market has not been fully effective.

## **The focus of the USO – should it be narrowed or broadened**

---

Vodafone submits that to maintain the effectiveness of the USO, the scope of the scheme needs to become more focused. Vodafone does not support increasing the scope of the USO – as currently defined – beyond fixed-line services, or increasing the cost to industry.

As above, the main objective of the USO is to ensure that all Australians have access to a basic telephony service, regardless of where they reside or work. Historically, this has resulted in the USO applying to a large number of households in rural and regional Australia. However, Vodafone believes that due to an increase in the level of competition and the introduction of Government programs for supply of telecommunications services to rural households, the potential use for the USO has been significantly reduced as the objective has been / is being met via various mechanisms.

Vodafone believes that the long term interest of rural and regional end users will be promoted by ensuring that the USO complements recently announced major funding agreements such as the Broadband Guarantee Fund and the OPEL rollout.

Such an approach is consistent with the Government's policy framework of delivering improved services and lower prices through the development of a competitive telecommunications market. That is, the Government's first priority is to encourage the market to supply telephone services to rural and regional consumers. The USO should only apply where the market fails to supply services.

We also note that this is consistent with the finding of the RTI – which has been accepted by the Government – that the USO is not an effective mechanism to provide broad consumer access to an increased range of services into the future<sup>2</sup>. Vodafone agrees that the legacy nature of the USO, the method of delivery, and costing and funding of the USO results in minimal innovation in terms of delivery.

*Vodafone submits that focusing the application of the USO is in the long-term interest of rural end-users, and is consistent with the RTI recommendations and the Government's policy framework.*

## **Given existing commercial and Government-funded networks, the USO should be considered a consumer safety net**

---

In the context of targeted Government subsidies, and given the significant changes in the telecommunications industry since the introduction of the USO, Vodafone believes that the USO should be a basic consumer safety-net guaranteeing access to a standard telephone service to households where the market does not provide alternative telecommunication services (including PSTN, mobile, satellite or VOIP services). This is consistent with the concept of 'provider of last resort'.

To ensure that the USO is targeted to where it will be of most benefit to consumers, the USO should only be available where it has been demonstrated that the market has not provided alternative telephone services to households. Vodafone believes that it should not be available where households have access to commercial services and it should not be offered on more favourable commercial terms than market-based offerings. Such an approach will ensure that the USO is consistent with the Government policy of providing targeted assistance.

Vodafone believes that the core question that must be addressed by the review is what households do not have access to telecommunications services and therefore would need to rely on the USO safety net. Vodafone notes that this analysis must take into account existing Government subsidies for other technologies.

*Vodafone submits that the USO be considered a consumer safety net – a guarantee that households have access to a basic telephone service where such services are not provided commercially.*

---

<sup>2</sup> Finding 7.3.

## What areas do not have access to metro-equivalent voice services?

The first question, therefore, in assessing the future role of the USO is to identify those Australian households that do / will not have access to market-supplied telephone services.

Since the 2004 USO Review, several Government programs have been introduced, providing telecommunications services to rural and regional areas, including:

- Broadband Connect Fund;
- Satellite Phone Subsidy Scheme;
- Australian Broadband Guarantee; and
- Preservation of the \$2 billion Communications Fund.

These programs ensure that 99 per cent of households will receive wholesale broadband services, and the remaining 1 per cent will receive subsidies to offset the cost of satellite technologies (\$2750 per household for broadband and \$1200 for satellite phone).<sup>3</sup>

The recently announced winner of the \$958 million broadband connect fund – OPEL joint venture between Optus and Elders – will cover almost 9.5 million households by June 2009 through:

- 1,361 WiMAX sites;
- 312 exchanges will also be enabled with ADSL2+ broadband and another 114 exchanges being enabled by Optus on a fully commercial basis; and
- 15,000km of fibre optic backhaul to extend the broadband highways that link rural areas back to major city centres.

Vodafone notes that the Government and OPEL have committed to providing equitable wholesale access to the network. The Government notes that:

*OPEL will offer a suite of wholesale services, including end-to-end broadband services for resellers, as well as various other options for wholesale broadband, voice services and bundled products ... OPEL Networks will assist regional ISPs and service providers to link into its network, through its extensive spur transmission links, or where necessary through building additional connecting links. (15000 backhaul fibre links).<sup>4</sup>*

Vodafone submits that the Broadband Connect Fund has significant implications for the role of the USO. The Government has made it clear that under this scheme, by June 2009, 99 per cent of households will have access to a wholesale broadband network either through ADSL or WiMax technologies. This means that rural consumers should be serviced by several different retail service providers, providing broadband and voice services to premises. Multiple providers will ensure that rural consumers are charged prices equivalent to, or better than, metro consumers.

Vodafone submits that households who will have access to the OPEL network should not need to rely on the USO scheme to ensure basic telephony – as their household will be connected commercially via OPEL's wholesale network. This means that rural consumers will have access to numerous commercial service providers rather than relying on one monopoly USO provider. Vodafone believes that this arrangement can only benefit rural consumers. We also note that this outcome is consistent with the policy framework of the Government through the use of commercial networks to provide advanced

<sup>3</sup> [http://www.minister.dcita.gov.au/\\_data/assets/pdf\\_file/69976/Fact\\_sheet\\_OPEL\\_Network.pdf](http://www.minister.dcita.gov.au/_data/assets/pdf_file/69976/Fact_sheet_OPEL_Network.pdf)

<sup>4</sup> <http://www.broadbandnow.gov.au/opel.htm>

telephone services.

*Vodafone submits that the Broadband Connect funding scheme means that the USO should only apply to the 1 per cent of households that are not to be covered by the OPEL network.*

## **The delivery of the STS under the USO**

---

As mentioned above, Vodafone believes that the USO should be treated as a consumer safety net, so that consumers who do not have access to market based telecommunications services have a guarantee to a basic telephone service.

Vodafone submits that the USO be used only to fund basic telephone services – the concept of STS should not be expanded to take into account advanced services that could be provided through different types of networks. Vodafone also notes that this is consistent with the RTI finding 7.3, which states that the USO is not an effective mechanism to provide broad consumer access to an increased range of services into the future. The Government has accepted this finding.

As noted in the Issues Paper, a STS is typically delivered over the PSTN network. However, Vodafone notes that in rural and regional areas, this may not be the most cost effective network over which to provide telecommunications services to households. For instance in many remote areas in developing countries telecommunications providers are building base stations to support a mobile network rather than digging trenches in areas where it is not cost efficient to do so.

Vodafone notes that given the deployment of the OPEL wholesale network, 99 per cent of households will have the choice of several service providers, most likely at metro-equivalent charges. In addition, 98 per cent of the population is covered by the Telstra Next G network. Based on these two networks alone, at least 98 per cent of the population will have a choice of retail providers and technologies through which to acquire telephony services.

Consequently, the USO – and the STS provided under it – is only relevant to the 1 per cent of households which do not have access to market based telecommunications services. Vodafone believes the relevant question is what is the most efficient and effective way to deliver the basic STS to these households. A requirement to provide a STS over a copper PSTN network would greatly increase the cost of the USO.

Vodafone believes that the efficiency and efficacy of the USO can be enhanced by enabling the USO provider to choose the least-cost technology through which to provide the basic telephony service to the relevant 1 per cent of households. However, consistent with the intent of the USO, the USO provider should only provide basic telephony services through the USO regime.

Vodafone does not support the use of USO funding to cross-fund the deployment, or enhancement, of mobile (2G or 3G) networks. This includes increasing coverage to infill areas inside the 99 per cent of households subject to competitive supply of services, or to guarantee that consumers are guaranteed coverage outside their household. The use of such funding in this manner would distort the competitive supply of mobile networks, and would likely damage the level of competition. Vodafone notes that such an outcome would be inconsistent with the policy objectives of the Government to develop competitive markets.

Vodafone strongly disagrees with any move to place an obligation on mobile or broadband service providers to provide services to all Australian households – as per the current USO obligations on the USP. If the Government decides not to update the USO requirements to make it a consumer safety net under the terms outlined above, then the requirement to provide a STS to all households should continue to only apply to PSTN services.

*Vodafone submits that the USO provider be limited to supplying only basic telephony, and ensure that USO funds are not used to cross-subsidise services in competitive markets, such as mobiles.*

*Vodafone believes that the USO provider should be free to choose the most effective and efficient technology through which to provide the basic telephone service to the most remote 1 per cent of households.*

*If the current USO system is retained, Vodafone strongly disagrees with any move to place an obligation on mobile or broadband service providers to provide services to all Australian households, or to use USO funding to improve coverage of mobile phone networks.*

## **The role of the CSG**

---

Vodafone supports the primacy of competition to ensure that consumers receive high-quality services and highly innovative products. However, this is not to say that there is no role for mandated minimum service levels. Vodafone believe there are two broad situations where minimum service levels should be applied:

- monopoly network provider; and
- government subsidised networks.

We recognise that there is a role for regulated minimum standards where services are provided over a monopoly network. In this limited case, Government mandated standards can lead to a welfare enhancing outcome. This in part explains the imposition of the CSG on the USO provider: in the absence of standards, when consumers experience substandard service levels, they have no option but to remain on the USO provider's network.

In addition, Vodafone believes that where firms receive Government funding to roll-out a network, the Government should also impose minimum service levels. Typically, Government assistance for network deployment occurs only where the market is unable to provide services on commercial basis. Consequently, consumers are unlikely to be serviced by several networks. For example, under the OPEL funding, there will be *one* wholesale network provider. That is, while consumers may have access to multiple service providers, all services will be provided over the same network – and retail providers may be unable to influence the customer performance of network-level elements.

Vodafone submits that minimum customer service guarantees should be applied to the USO provider and to the OPEL network. The nature of the guarantees would need to reflect the technology used in each network.

*Vodafone submits that the CSG should not be extended to networks that are competitively supplied.*

*Vodafone submits that the CSG – or similar obligations – should be placed on the OPEL network. This will ensure that rural consumers are protected against substandard network service.*

## **Funding the USO scheme**

---

Vodafone supports continuing the decreasing trend in the cost of the USO. We believe that the cost of the USO will be substantially reduced by ensuring that it is focused to the households that need access to the consumer safety net – that is, households that are not covered by commercially supplied networks, and / or networks funded by Government.

Currently, the cost of the USO is recovered from the Industry. Vodafone notes that the Telstra, Optus and Vodafone contribute 91 per cent of the total USO fund. Vodafone believes that an assessment of the appropriateness of this approach needs to examine whether the USO scheme meets the Government's cost-recovery guidelines.

The Australian Government's cost recovery guidelines<sup>5</sup> state that a program should not be cost recovered where it is not efficient or cost effective to do so. There are several reasons why the cost of a regulation should be recovered directly from industry. These include:

- enhancing efficiency;
  - users will better recognise the cost of providing the service and can adjust their consumption in line with their willingness to pay for the service;
  - government agencies receive price signals about which products and services are in demand and which are not;
- increase equity by making the beneficiaries of government services pay for the cost of providing services.

Vodafone submits that recovering the cost of the USO from the industry does not increase the efficiency of its delivery, nor is it more efficient than funding the USO through consolidated revenue. Importantly, under the current funding arrangements, all parties bearing the cost burden – except Telstra – do not benefit from the scheme.

One possible justification for an industry levy is that firms will pass on the burden of the levy onto consumers – therefore telecommunications consumers will in effect pay for the USO subsidy.

In reality, however, the level of competition in the retail mobile markets results in mobile-only operators – Vodafone and Hutchison – incurring the incidence of the USO levy so that the cost burden falls disproportionately hard on mobile-only providers. Economic principles state that the incidence of the USO charge does not fall onto end-users when firms operate in competitive retail markets – the retail mobile market. However, integrated operators are able to pass the USO cost onto consumers in markets that are less competitive, such as the fixed-line market.

There are two main beneficiaries of the USO scheme: Telstra as the USO provider, and rural end-users. While cost recovery principles state that the beneficiary-pays principles generally should be applied, it does not apply where it is against stated Government policy. Vodafone notes that making rural households pay more for the right to have metro-equivalent services is against the policy intent of the Government. However, Vodafone believes that there is little justification for Telstra to be funded for a

---

<sup>5</sup> See the Department of Finance's website – [http://www.finance.gov.au/finframework/cost\\_recovery.html](http://www.finance.gov.au/finframework/cost_recovery.html)

service that it receives significant benefits – indeed as a beneficiary of the USO scheme, Government guidelines dictate that it should pay for the service.

We consider that the regime, as currently structured, gives Telstra significant competitive advantages. Firstly, we do not believe that the provision of USO services requires specific funding from either the Government or industry. While we acknowledge that Telstra does incur real costs in providing services to meet the USO requirements, we consider that these costs need to be weighed against the benefits that Telstra receives from providing service to these customers. These include direct revenues from telecommunications products and services purchased by USO customers – as well as the important intangible benefits that Telstra receives from providing these services (eg. the enhancement of Telstra's brand). We consider that the benefits received from providing the USO would largely offset the costs incurred. As a result, the current USO regime represents a transfer of wealth from industry participants to Telstra, as the provider of USO services.

If the Government judges that USO costs do outweigh the benefits that accrue to Telstra, then the question arises as to how such costs should be funded. At present the industry funds the USO. However, Vodafone believes it is inappropriate for the Government to impose on industry a specific upfront tax to deliver a social policy outcome. If the Government considers that the market is unable to deliver certain social policy outcomes, then the most appropriate approach would be to contract with the industry to provide the service and fund this using consolidated revenue.

Since the USO is a consumer safety net – guaranteeing all consumers that at a minimum they will have access to a basic telephone service – Vodafone submits that efficiency dictates that it is funded through the general taxation system.

*Vodafone submits that the USO be funded by the Government through general taxation.*

*Vodafone submits that if the USO is to continue to be cost-recovered it must be recovered solely from Telstra – Government guidelines state it should be recovered from the beneficiary of the scheme.*