

# TELECOMMUNICATIONS (CONSUMER PROTECTION AND SERVICE STANDARDS) AMENDMENT BILL (NO.2) 2000

## Introduction

1.1 On 28 June 2000, the Senate referred the Telecommunications (Consumer Protection and Service Standards) Amendment Bill (No. 2) 2000 to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee (Selection of Bills Committee Report No. 10 of 2000). The Committee was required to report to the Senate by 25 August 2000. The Committee sought an extension from the Senate to report on 29 August 2000.

## The Bill

1.2 The Telecommunications (Consumer Protection and Service Standards) Amendment Bill (No. 2) 2000 amends Part 2 of the *Telecommunications (Consumer Protection and Service Standards) Act 1999*, the part of the Act that establishes the universal service regime for telecommunications. The universal service obligation (USO) ensures that the standard telephone service (ie. voice telephony), payphone and other prescribed services are reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business. The complementary digital data service obligation (DDSO) underpins access on request to a 64kpbs (or comparable) data service.<sup>1</sup>

1.3 As part of the sale of the second tranche of Telstra in 1998, Parliament allocated \$150 million (referred to as a “Social Bonus”) to provide untimed local calls in remote Australia (the Extended Zones). In accordance with decisions announced by the government on 23 March 2000<sup>2</sup>, the *Telecommunications (Consumer Protection and Service Standards) Amendment Act (No. 1) 2000* amends the existing universal service regime to give the successful tenderer for the provision of untimed local calls to a particular region, the certainty that it will become the regional universal service provider (USP).

1.4 In his second reading speech for the earlier legislation, the Minister indicated that a further Telecommunications (Consumer Protection and Service Standards) Amendment Bill (No. 2) would be introduced to implement the government’s other decisions. More substantive than the first Act, this second Bill seeks to implement all elements of the government’s USO package announced on 23 March 2000.<sup>3</sup>

1.5 The key objectives of the Bill include:

- amending the universal service regime to improve its general operation, particularly in relation to contestability, costing and funding;

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1 Explanatory Memorandum, Telecommunications (Consumer Protection and Service Standards) Amendment Bill (No. 2) 2000, p. 2

2 For further details, see Explanatory Memorandum, Telecommunications (Consumer Protection and Service Standards) Amendment Bill (No. 2) 2000, pp. 2-3

3 Explanatory Memorandum, Telecommunications (Consumer Protection and Service Standards) Amendment Bill (No. 2) 2000, p. 3

- undertaking two pilot schemes in regional Australia to trial the competitive supply of services under the USO; and
- extending the funding base for the USO and DDSO to include carriage service providers as well as carriers.<sup>4</sup>

### **The Committee's inquiry**

1.6 The Committee advertised its inquiry in each State capital newspaper as well as in *The Weekend Australian* and *The Financial Review*. Details of the inquiry were also placed on the Committee's homepage on the Internet.

1.7 The Committee received 7 submissions, 5 of which went to the core of the issues addressed in the Bill. The list of individuals, organisations and agencies making submissions is at Appendix 1 to this report. All submissions received are publicly available through the Committee Secretariat.

#### *Public hearing*

1.8 The Committee held a public hearing in Canberra on 18 August 2000. The list of witnesses who appeared at the hearing is at Appendix 2.

### **The evidence**

#### Contestability

1.9 Most witnesses expressed broad support for the introduction of contestability for the USO subsidy. For example, Vodafone commented that the Bill helps to overcome a "huge hurdle ... in providing services in rural Australia" by opening up the subsidy to competition, thereby allowing all carriers to have "an equal opportunity" in accessing the subsidy through provision of services in rural Australia.<sup>5</sup>

1.10 Vodafone also stated that customers would be the major beneficiaries of the changes to the legislation by having a choice of carrier as well as a choice of technology. In Vodafone's view, this would result in an increase in the range of services.

1.11 Cable and Wireless Optus also supports USO contestability for similar reasons.<sup>6</sup>

1.12 The Communications, Electrical and Plumbing Union (CEPU), however, voiced its concerns with the Bill, in particular with what it described as a "dismantling of a very

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4 Explanatory Memorandum, Telecommunications (Consumer Protection and Service Standards) Amendment Bill (no. 2) 2000, p. 3

5 *Transcript of evidence*, p. 1

6 Cable and Wireless Optus stated at hearing:

We think it is going to provide benefits to customers in rural and remote areas. They will be able to have a choice of carrier and a choice of services that they wish to access. We think that this contestability will open up service provisions so that better services will be provided across the board. (*Transcript of evidence*, p. 30)

important asset for Australia, ... the national telecommunications system”.<sup>7</sup> The CEPU commented that:

One of the things that cannot be walked away from is that this universal service obligation is a loss service. It is a nonsense for people to be saying that competition for a loss service will have people vying to enter into it in the way that it is provided now.<sup>8</sup>

1.13 The CEPU contended that, even if customers were given greater variety of carriers and technologies through contestability, the competition for loss-making services would inevitably lead to increased USO costs.

1.14 The Department of Communications, Information Technology and the Arts (DoCITA) stated in its evidence that there appears to be fairly broad support for change to contestability and for the broad direction of the legislation package. Where there are differences of view, these tend to focus on second and third order implementation details rather than on the broad principles.<sup>9</sup>

1.15 The Department explained that the government is introducing contestability by means of a staged approach, and hence the proposed pilot scheme allows for flexibility for ‘fine tuning’ as the system is implemented. The staged approach that has shaped the design of the current arrangements relies on key principles of the primacy of consumer interests, and ensuring that a responsible approach is taken to the costs of the USO and to the industry as a whole.<sup>10</sup>

#### Incentives for Telstra

1.16 A number of witnesses expressed concern that, if Telstra were displaced as the sole USP, it would have no commercial incentive to maintain its infrastructure over the period that it was not providing the universal service. For example, the CEPU stated:

... [Telstra] would not be unhappy not to be the principal provider in these loss-making areas, particularly if they can ‘cherry pick’ the main customers in those areas. Once they were not, why would they maintain any infrastructure in those areas? ... They would get out of there fast. They do not want to be there now because it makes losses. As soon as someone else was the principal universal provider they would be out of there: they couldn’t wait.<sup>11</sup>

1.17 Telstra indicated in its evidence that, in the event that it was not successful in bidding for universal service provision, any decision on maintaining existing infrastructure would be made on a commercial basis. Telstra commented:

There are costs of maintaining infrastructure. If we no longer have to be there and we have sunk assets, the financial decision is somewhat different than an ongoing

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7 *Transcript of evidence*, p. 10

8 *Transcript of evidence*, p. 10

9 *Transcript of evidence*, p. 36

10 *Transcript of evidence*, p. 36

11 *Transcript of evidence*, p. 12

responsibility to provide service there. ... It would be almost an area by area, infrastructure by infrastructure, customer by customer proposition for us to consider.<sup>12</sup>

1.18 In its evidence to the Committee, DoCITA clarified some issues in this regard. The Department stated that a condition of the Extended Zone tender is that the successful tenderer will become the USP on an ongoing basis; the tender would not be relet at the end of a three-year period, as some witnesses appeared to assume. The Department commented that the tender documentation makes it clear that, no matter who wins the tender, one of the obligations they accept is that they become the Primary Universal Service Provider (PUSP), “basically forever”.<sup>13</sup>

1.19 DoCITA explained that the Minister would need to exercise his powers to designate another carrier to be the PUSP, which is a disallowable decision. The PUSP has no right to discontinue service for any reason.<sup>14</sup>

1.20 The Department addressed the question of Telstra’s decision not to maintain its infrastructure if it did not win the tender by stating that the government would accept that decision and at this stage had no intention at all of interfering with Telstra’s opting to vacate the field.<sup>15</sup>

1.21 However, DoCITA also refuted the suggestion in Telstra’s submission that the proposed process will perpetuate a system with USO that acts against investment in infrastructure. Instead, the Department argued that contestability would encourage Telstra to increase its investment. The DoCITA witness commented:

I would have thought that a system which said, ‘Here are some incentives for people to enter the market and to start providing services’, is in fact completely the opposite of that. There could be an argument that at least under the current system Telstra provides services in a particular year and at the end of the year they get paid a lump sum of money irrespective of the level or standards at which they provide the services. If the level and standard get covered off in regulation, there is very little incentive for Telstra to invest at the moment. ... I would have thought that a system that has got an incentives-based approach to things, where you actually have to try to get customers and retain customers and focus on customers if you want to get the universal service money, is much more likely to generate investment and focus on consumers, which is one reason why the government has, I suppose, gone down this path.<sup>16</sup>

### Costings

1.22 A number of witnesses raised the issue of cost barriers that are to be overcome in providing services to rural Australia, which are more expensive than service provision in metropolitan Australia. The CEPU, in particular, voiced concern that competitive tendering

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12 *Transcript of evidence*, p. 24

13 *Transcript of evidence*, p. 36

14 *Transcript of evidence*, p. 37

15 *Transcript of evidence*, p. 42

16 *Transcript of evidence*, p. 42

would bring no savings to the community, but would likely lead to increases in the total costs borne by industry.<sup>17</sup>

1.23 Vodafone acknowledged the cost barrier as an issue, but regarded this as an opportunity to work on economies of scope. In particular, Vodafone believes that, for the same order of magnitude of capital outlay, its revenue would increase quite significantly through economies of scope by being able to bundle a mobile service with a standard telephone service.<sup>18</sup>

1.24 Cable and Wireless Optus, however, expressed some concern that the current approach to USO contestability will not work in practice, as new entrants will be reluctant to enter and unlikely to compete in USO areas. Cable and Wireless Optus believes that the costing model will overcompensate Telstra for the risk and stranded assets which in turn will drive up the USO costs in pilot areas. Such costs will impact back on the industry, driving up costs generally. Therefore, Optus submits, USO costs will increase as contestability is introduced, rather than decrease, and benefits to consumers will not be delivered.<sup>19</sup>

1.25 Telstra also expressed difficulties with costing of the USO, commenting that the obligation should properly be viewed as a tax on industry. For this reason, costing and funding arrangements are important in determining the size and incidence of that tax. In this context, Telstra is critical of the costing process as envisaged by the legislation, claiming that there has not been a year since 1991 that the process has worked. Telstra commented:

Costs do not disappear because the legislation says you do not recognise them. It merely meant that Telstra had to pay the unrecognised amount – 100 per cent of that tax – and everybody else contributed a share of the recognised amount. That is, if you like, the history. Going forward, there is not even a cost concept in this Bill, and to us that is extraordinary. We have a requirement on Telstra, at least in the near term, to be the carrier of last resort of the primary universal service provider throughout Australia, and yet any concept of cost recovery does not exist in the legislation ... We would like the legislation to reflect that the supplier of a universal service does receive the costs of supply.<sup>20</sup>

1.26 Other carriers who gave evidence opposed the payment of a premium subsidy to Telstra as carrier of last resort. Vodafone described the position in this regard as the level of risk and exposure that a carrier has in providing services in rural Australia. In Vodafone's submission, the risk to Telstra of losing customers and incurring economic loss as a consequence is potentially less than the cost to Vodafone. Vodafone envisages a high level of retention by Telstra of customers in rural areas and estimates its risk in winning customers from Telstra to be at least equal to Telstra's risk in retaining its customers.<sup>21</sup>

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17 *Transcript of evidence*, p. 11

18 *Transcript of evidence*, p. 2

19 *Transcript of evidence*, p. 30

20 *Transcript of evidence*, p. 22

21 *Transcript of evidence*, p. 6

1.27 Therefore, Vodafone argues that for Telstra to receive a premium on top of what a competing USP receives is “just funding inefficiency within Telstra”.<sup>22</sup> In its view, that premium could act as a disincentive as it would make it harder for Vodafone to compete.

1.28 Cable and Wireless Optus similarly contends that the premium payments to Telstra are unnecessary as they only increase the cost of the USO. Optus does not believe that Telstra needs to be the carrier of last resort or the PUSP, and is prepared to undertake that role for no additional compensation.<sup>23</sup>

1.29 On this issue, DoCITA indicated in its evidence that it is examining ways of improving the machinery of the legislation to overcome the sorts of problems with payments raised by Telstra.<sup>24</sup>

### Arbitrage

1.30 Telstra expressed particular concern that the entry of competing USPs into the field opens up opportunities for forms of competitive distortion, such as arbitrage.<sup>25</sup> Telstra supplies local call resale at a nationally averaged rate, by regulation. Price controls require it to nationally average its untimed local call price. Telstra’s concern is that a competitor with no infrastructure could use that nationally averaged price and supply universal services through resale, thereby collecting a subsidy as if they were providing infrastructure to an area yet merely reselling Telstra’s service that Telstra could be supplying at below cost.

1.31 To remedy this situation, Telstra suggests that a USP that relies on resale should not receive a USO subsidy. Further, Telstra proposes that the ACA and the Australian Competition and Consumer Commission (ACCC) align their approaches to network costing in USO areas to avoid any effect on competition in contestable areas that would arise from costing differences.<sup>26</sup>

1.32 DoCITA does not share Telstra’s concern that competing service providers would try to build their entire business based on reselling Telstra’s network, describing the likelihood of this as “extremely remote”.<sup>27</sup> The Department believes that building a business based purely on arbitrage, particularly in regional areas, would be a “very difficult business ... to sustain”.<sup>28</sup> Such a business would need to rely on an agreement with Telstra on access and interconnection for use of Telstra’s facilities. In the event of arbitrage, DoCITA argues that Telstra would approach the ACCC immediately to have the access arrangements varied. The Department commented:

Telstra take the view in their submission that, because they have nationally averaged rates for doing things, somebody else will come along with a nationally averaged rate and try to take advantage of that to build a business. I would not

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22 *Transcript of evidence*, p. 7

23 *Transcript of evidence*, p. 30

24 *Transcript of evidence*, p. 43

25 *Transcript of evidence*, p. 21

26 *Transcript of evidence*, p. 22

27 *Transcript of evidence*, p. 44

28 *Transcript of evidence*, p. 44

want to prejudge the ACCC's views on this, but if there were a dispute about that access and interconnection agreement in terms of conditions, that it would be in the long-term interests of end users. Telstra would probably have quite a strong case to say that, in this case – where there are universal service subsidy arrangements applying and this person is clearly just trying to use the system to build an arbitrage business – it is not in the long-term interest of end users. Telstra could probably go to the Commission to seek to have that varied.

I think that the very fact that Telstra could do that would act to discourage people from coming in to try to build a business solely or largely on the basis of arbitrage. ... The ACA would have to look at any arrangement like that to make sure it was fair to consumers.<sup>29</sup>

### Pilots

1.33 Vodafone, in particular, welcomes the trial scheme in pilot areas provided by the Bill. The pilots would enable Vodafone to trial innovative packages in rural areas which would provide the carrier with statistical and other information to test its belief that some customers may prefer a mobile service over an untimed local option. Vodafone regards the pilot scheme as presenting only limited risk to the government with the consumer as the beneficiary due to the option of moving to an alternative service if that meets the particular needs of customers.<sup>30</sup>

1.34 Cable and Wireless Optus suggested that the first pilot should be introduced in areas close to where providers have existing infrastructure, to attract new providers to enter the market.<sup>31</sup>

1.35 Telstra supports the trial as potentially informative of technical capabilities; the costs of service delivery; and the willingness of customers to accept price and quality trade-offs.<sup>32</sup>

1.36 However, Telstra cautions that Parliament needs to have feedback on whether the contestability pilots have been successful or not in order to decide on the Minister's proposal for areas where contestability will be introduced.<sup>33</sup>

1.37 The CEPU raises a similar concern about legislative ambit in the Bill when entering into the post-trial environment. The Union comments:

... [W]e believe that these trials need to be viewed with a great deal of scepticism and caution. As a minimum, there needs to be provision in the legislation itself – not just a policy statement by government, but provision in the legislation – for a review of their outcomes – we would suggest within a three-year time period of them having started – and that the Minister ... should not be able to proceed to

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29 *Transcript of evidence*, p. 44

30 *Transcript of evidence*, p. 3

31 *Transcript of evidence*, p. 33

32 *Transcript of evidence*, p. 20

33 *Transcript of evidence*, p. 20

declare any other new areas contestable until that review has been conducted, a report tabled in the Parliament and the subject of full debate.<sup>34</sup>

1.38 DoCITA indicated in its evidence that the Bill takes a holistic approach to the trials scheme and continuing implementation of the contestability model. The Department stated:

Basically, what the Bill does is set up a framework for introducing contestability over time. It does not specifically identify: here are the pilots and here are later stages of the process. The government has made announcements that it proposes to start these two pilot areas but the Bill in fact does not make the distinction between pilot areas and other areas. ... We would take the view that all of the provisions of the Bill are required both to do the pilots and for the ongoing arrangements. ... Effectively what the Bill does is establish an overall system. It says: here are the overall arrangements; here is a default contestability scheme.<sup>35</sup>

1.39 DoCITA advised that there are no formal arrangements in the Bill to conduct a review process at the conclusion of the trial period. The Department is proposing to monitor the pilots by means of administrative arrangements. While the details of these arrangements have yet to be finalised, DoCITA provided the following comments with the regard to the process:

In very broad terms, [the criteria] are going to be issues like: how administrable are they going to be; how are the administrative arrangements working; how effective have we been in getting competition to come in; what do the costs in broad terms look like and how have the costing arrangements worked; how do things look from the consumer perspective; and in particular what is the level of consumer understanding about the process. Effectively, we will look at how workable have the arrangements actually been and how successful have they been both in ensuring that we continue to have the universal service provided in an effective way and also in increasing choice for consumers at the same time.<sup>36</sup>

#### Discretionary Ministerial powers

1.40 Telstra, in particular, was concerned at the wide discretionary powers given to the Minister and the ACA in the legislation, with no reference to matters to be considered or evaluated in making a particular decision.<sup>37</sup>

1.41 DoCITA indicated that many of these issues are being addressed, explaining that the government intends to move some amendments to the Bill in the Senate:

... [T]he government will be moving some amendments to the Bill. Those amendments will be covering off matters such as consequential and transitional. Currently there are not any consequential provisions and transitional provisions between the old regime and the current one.

We will also be incorporating all of the amendments that were made by the Senate in relation to Universal Service Bill (No. 1) so that the Bill reflects and

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34 *Transcript of evidence*, p. 11

35 *Transcript of evidence*, p. 37

36 *Transcript of evidence*, p. 38

37 *Transcript of evidence*, pp. 19-20



incorporates those issues that the Senate had a view on last time. We will probably be including some further provisions with some further penalties. There is a penalty regime built into the current Bill in the sense that everything in the Act is a licence condition and so carriers are required to comply that way. We will also be incorporating some specific penalty provisions in relation to certain aspects of the legislation. One other matter, which we will probably be incorporating as amendments, is that during the drafting process there were a couple of oversights. A couple of Ministerial or ACA determinations which were not disallowable which probably should have been, and they will be incorporated in those amendments as well.<sup>38</sup>

### Alternative Telecommunications Services

1.42 The CEPU raised its concern that the ATs do not appear to be necessarily subject to any regulatory price controls. The Union stated:

It is not clear whether they will be subject, for instance, to customer service guarantee provisions or where they will sit in relation to the customer service guarantee. For instance, these services may be mobile services which are not at present captured by the customer service guarantee ... Particularly in the area of pricing, we never tire of saying that the USO is not really a function of costs, it is the subject of prices, because if the USO provider were free to charge any price ... for the services offered, there would be no reason not to charge at least at a recovery level and there would not be a loss and there would be nothing to be funded. So if a provider can offer alternative telecommunications services in lieu of the USO and still be subsidised or given some sort of payment for doing it, it opens up the possibility of their charging perhaps more for a certain service than is currently the regulated price under the price capping regime, or at least alternatively trading off service quality against price and so squeezing more out of the service offering.<sup>39</sup>

1.43 In this context, Telstra raised the issue of a competing USP delivering an alternative service at a higher or lower level of quality than the standard service that the PUSP is obliged to deliver. In Telstra's view, this could result in a situation where carriers delivering different services at different cost structures with different levels of features all receive the same level of subsidy.<sup>40</sup>

1.44 DoCITA clarified in its evidence that the Bill allows for the possibility of a primary universal service provider being able not only to supply the standard telephone services as defined in the legislation but in addition – without derogating from its obligation to supply that standard of service – provide alternative telecommunications services. The standard of those alternative services would be a matter for the provider to submit to the ACA and for the authority to take account of in deciding whether to approve that service.<sup>41</sup>

1.45 The Department commented that the Bill specifies a process for the ACA to consider proposals for ATs by comparing services currently available in the marketplace and

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38 *Transcript of evidence*, p. 40

39 *Transcript of evidence*, p. 16

40 *Transcript of evidence*, pp. 20-21

41 *Transcript of evidence*, p. 39

assessing the basic requirements of consumers. The additional services have to meet the fundamental requirements of the USO, including provision of the standard telephone service, which in turn requires voice telephony. The ACA would also have regard to technical standards applying to provision of the standard telephone services in respect of matters such as noise, delay, and data rates.<sup>42</sup>

1.46 DoCITA stated further that the Bill (at clause 13Q(2)) requires the core providers to submit a marketing plan for their ATS with certain mandatory specifications. The Department commented:

The ACA, for example, make judgments about to what extent they think the ATS will be able to meet the universal service obligation for the area concerned, that those services are of general appeal and appropriate for filling the obligation, that they set out appropriate terms and conditions on which the equipment, goods and services are to be supplied, that they set out appropriate arrangements for the marketing of those services to people – in other words that consumers are informed about the services, and that there are appropriate procedures in place effectively about the supply of those and for customer complaints.<sup>43</sup>

#### Public health and safety

1.47 One submission, from the Maleny Residents' Action Group (Submission No. 7), alluded to public health and safety concerns that it has raised with Telstra in relation to a mobile telephone base in the township of Maleny in Queensland. The submission expressed concern that digital technology may hold potential risks for public health and safety that have yet to be subject to independent scrutiny and research to assess any possible short and long-term impacts.<sup>44</sup> The Committee notes the submission's comments but they are more relevant to the Senate Environment, Communications, Information Technology and the Arts References Committee's current inquiry into Electro-Magnetic Radiation.

#### **Conclusion**

1.48 Having considered the Bill and the issues raised in submissions received and in evidence at hearing, the Committee makes the following recommendation:

#### **Recommendation**

**The committee recommends that the Bill be passed.**

**Senator Alan Eggleston**

**Chair (LP, WA)**

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42 *Transcript of evidence*, p. 40

43 *Transcript of evidence*, p. 40

44 *Submission No. 7*, p. 1