TELECOMMUNICATIONS LAWS AMENDMENT (UNIVERSAL SERVICE CAP) BILL 1999

Background

The Universal Service Obligation

1.1 The Universal Service Obligation (USO) is a core regulatory obligation of the telecommunications industry, which has the aim of ensuring that all persons in Australia have access to a minimum level of telecommunications services in cases where the market would not be likely to otherwise supply those services.[1]

1.2 Section 138 of the *Telecommunications Act 1997* states that the object of the Universal Service Obligation is to ensure that:

(a) all people in Australia, wherever they reside or carry on business, should have reasonable access, on an equitable basis, to:

   (i) standard telephone services; and

   (ii) payphones; and

   (iii) prescribed carriage services;[2]

1.3 The Section also states that the USO 'should be fulfilled as efficiently and economically as practicable'; that 'the losses that result from supplying loss making services in the course of fulfilling the USO should be shared among carriers'; and that the information according to which those losses (and the respective carriers' shares of the losses) are determined, should be open to scrutiny by the carriers and the public 'to the greatest extent possible without undue damage being caused by the disclosure of confidential commercial information'.[3]

1.4 The *Telecommunications Act 1997* gives the Minister power to designate a 'universal service provider' who has primary responsibility for the delivery of the USO. The Minister also has the power to declare a specified carrier as a 'regional service provider' (Section 150). Telstra is the current universal service provider.

1.5 Sections 155 and 156 of the Act also allow the Minister to declare two or more carriers as universal service providers, or regional service providers, and for their responsibilities for delivery of the USO to be accordingly limited. On 6 April 1999 the Minister for Communications, Information Technology and the Arts, Senator Richard Alston, invited carriers to make expressions of interest in a competitive tender for the delivery of the USO, and announced the release of a public discussion paper on the process.[4] The outcome of

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1 Department of Communications, Information Technology and the Arts, Submission 4, p 3.

2 *Telecommunications Act 1997*, p 129.

3 *Telecommunications Act 1997*, p 129.

4 Senator Richard Alston, Ministerial Media Release, 6 April 1999.

this process (of which many details are still the subject of public consultation) may have implications for the future cost of the USO.

1.6 Division 4 of the *Telecommunications Act 1997* also obligates the declared universal service provider(s) to supply the Minister with a draft 'universal service plan' outlining how they intend to fulfil the USO in their area of responsibility. The Minister may refuse to approve the plan and direct the carrier to submit a modified draft plan if necessary. When the plan is approved the carrier is obligated to 'take all reasonable steps to ensure that the plan is complied with.' However the Act does not provide for penalties, and its language creates some leeway in judgements about whether the USO plan has been adequately fulfilled.[5]

1.7 On 1 December 1998 the Minister asked the ACA to conduct a review of Telstra's universal service plan, with an initial reporting date of 31 March 1999. The review has been completed, and is currently under Ministerial consideration. It has not yet been made public. The ACA was required to report on 'the extent to which Telstra's USP is satisfactory and areas where the government should consider requesting Telstra to improve its USP.' Particular attention was to be given to the supply of interim services using satellite phones; arrangements for people with disabilities; payphone services; and connection and fault repair times, particularly in remote communities.[6] The outcome of this review could also affect the future cost of the USO.

How the USO is funded and calculated

1.8 The USO has its origins in the Community Service Obligations specified in the *Australian Telecommunications Corporation Act 1989*, and was formally created under the *Telecommunications Act 1991*. During the period of this legislation an industry cross subsidy arrangement was calculated and Optus and Vodafone were the only other carriers required to contribute to the USO cost. The 1991 Act required Telstra to submit a claim for its net universal cost (NUSC) each year according to a formula of 'avoidable costs minus revenue foregone' developed by the Bureau of Transport and Communications Economics (BTCE) in 1988. Avoidable costs is the amount by which Telstra's operating and capital costs (including the opportunity cost of capital) exceed the costs it would have incurred had it not supplied loss-making services. This amount is reduced by the revenue received from loss-making areas to achieve the final NUSC.[7]

1.9 In order to resolve differences over Telstra's claim for 1993-94, the NUSC was agreed by negotiation between the carriers to be $230 million for that year, and indexed by the CPI after that. By 1996-97 the NUSC had risen to $251.56 million and was divided among the carriers according to market share (defined as each carrier's minutes of total timed traffic). That year Vodafone paid $2.13 million, Optus $23.07 million and Telstra $225.49 million.[8]

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5 *Telecommunications Act 1997*, pp 144-149. A copy of Telstra's 1998 Universal Service Plan can be obtained from the ACA website at http://www.aca.gov.au/consumer/usp.htm

6 Australian Communications Authority, *Universal Service Plan Review Discussion Paper*, p 1.

7 Department of Communications, Information Technology and the Arts, Submission 4, pp 3-4.

8 Department of Communications, Information Technology and the Arts, Submission 4, pp 3-4.

1.10 The Telecommunications Act 1997 retained the formula of avoidable cost minus revenue foregone to calculate the NUSC, but used carriers' 'eligible revenues' rather than timed traffic to calculate market shares. (Eligible revenue is precisely defined in a regulation, but is broadly based on a carrier's telecommunications revenues less deductions such as interconnect charges paid to other carriers for access to their networks). The 1997 Act also enhanced the USO scheme by more precisely defining the services contained in the USO; adding the National Relay Service to the USO and aligning the USO with the requirements of the Disability Discrimination Act; requiring the USO provider to submit a USO plan for approval; and providing greater flexibility to add services to the USO.[9]

1.11 After disputes between the carriers emerged after Telstra's 1993-94 NUSC claim, steps were taken to develop a more acceptable costing model than that developed by the BTCE in 1988. A consultant delivered a report to the ACA's predecessor AUSTEL in 1995, and in 1996 Bellcore International was engaged to build a fully documented and operational costing model on the basis of its recommendations. The ACA approved version 1.3.1 of the Bellcore model on 26 October 1998 and is using this model to assess Telstra's 1997-98 claim. Telstra, Optus and Vodafone have all approved the Bellcore model.[10]

Telstra's claim

1.12 Using the Bellcore model, Telstra submitted a claim to the ACA for a NUSC of $1.828 billion for 1997-98, in comparison with the previous year's cost of $252 million. The ACA stated the claim was some seven times higher than that for previous financial years and has surprised many industry participants. However they cautioned that:

> A direct comparison between these numbers may be unfair and fail to take into account the different circumstances. The NUSC number for 1992/3 of approximately $149 million was based on a costing model that was shown by a consultant to contain assumptions which were out of date or inappropriate.[11]

1.13 The ACA further explained that because of a lack of agreement between the carriers on the 1993/94 figure it was agreed, pending the development of an alternative costing model, that it should be $230 million. The NUSC for subsequent years has simply been based on that figure plus increases in the CPI.[12] Thus is it clear that the Bellcore model was likely to result in a different NUSC than has been the case since 1993/4.

1.14 In explaining the need to impose a cap on the NUSC, the Government has stated that the magnitude of Telstra's claim 'created potential for significant uncertainty in the telecommunications industry':

> If the claim were upheld, the sevenfold increase in levy contributions would be likely to severely damage all of Telstra's competitors to the detriment of continued competition in the industry; and

9 Department of Communications, Information Technology and the Arts, Submission 4, pp 4-5.

10 Australian Communications Authority, Submission 9, p 4.

11 Australian Communications Authority, Submission 9, p 6.

12 Australian Communications Authority, Submission 9, pp 6-7.

> Even if the claim were to be reduced considerably on assessment, the uncertainty about potential liabilities created by the claim during the assessment period had the potential to cause serious destabilisation in the telecommunications industry and deter investment.[13]

The Bill

1.15 The Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 was referred to the Senate Environment, Communications, Information Technology and the Arts Legislation Committee on 31 March 1999 by the Selection of Bills Committee (Report No 5 of 1999). The Committee was required to report to the Senate by 30 April 1999.

1.16 This bill amends the *Telecommunications Act 1997* and the *Telecommunications (Consumer Protection and Service Standards) Act 1999* with the aim of imposing a cap on the net universal service cost (NUSC) for the 1997-8, 1998-99 and 1999-2000 financial years.

1.17 In the absence of agreement between the carriers about a cap on the universal service cost for the 1997-98 financial year, the Bill will cap the NUSC at $253.32 million, which is the agreed 1996-7 figure plus CPI. If the cap is required in the following years, the cap will remain at an equivalent amount increased by the level of the CPI.

1.18 The Government has stated that the cap is an interim solution only, to create time for it to conduct a 'measured and orderly review of future USO funding arrangements'. The Government expects to carry out the review during 1999 and enact any changes to the USO funding arrangements before the commencement of the 2000-2001 financial year.

1.19 The Bill also gives the Minister a power to determine different amounts for the 1998-99 and 1999-2000 years (by a disallowable instrument) 'in case any policy refinements arising from the intended review can sensibly be implemented in relation to either of those financial years or to reflect any changed circumstances.'[14]

Issues arising from the Bill

Overview

1.20 The need for the measures proposed in the Bill has been raised firstly, by Telstra's far higher claim for the NUSC than in previous years, and secondly, by the likelihood of an inevitable change in the NUSC as the new Bellcore model was adopted as the basis for the assessment and calculation of the NUSC. The Committee agrees with the Government when it suggests the size of Telstra's claim has produced a great deal of uncertainty within the industry which needs to be addressed; however the adoption of the Bellcore model would have been likely to produce a different figure from previous years, and obviously raises important medium and long-term issues for the funding and viability of the USO.

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13 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, pp 4-5.

14 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, pp 2-3.

1.21 The Bellcore model was intended to be the basis for long-term industry agreement of the NUSC and industry contributions to it; however it appears that if the ACA's determination is greater than previous years, the Government would disregard this Bellcore derived figure and move to protect the industry through the cap:

> Even if [Telstra's] claim were to be reduced considerably on assessment, the uncertainty about potential liabilities created by the claim during the assessment period has [s] the potential to cause serious destabilisation in the telecommunications industry and deter investment.[15]

1.22 The explanatory memorandum to the Bill defines the Government's policy priorities in this area as:

- to preserve the service and affordability guarantees of the universal service regime;
- to preserve the viability, financial stability and competitiveness of the industry and encourage continued investment; and
- to provide certainty to the industry so that it can plan for its USO levy obligations.[16]

1.23 Submissions to this Inquiry identified the following issues arising from the Bill:

- Is the amount of the cap specified in the Bill both reflective of the true NUSC and/or adequately compensate the universal service provider for the cost of the USO? Could the Bill, in the event of a discrepancy between the assessed NUSC and the cap, create further financial liabilities for the Commonwealth?
- Should the amount of the cap specified by the Bill be changed, or should the Bill implement alternative options suggested in the explanatory memorandum or submissions?
- Does the Bill create a precedent for sidelining the ACA as an independent arbiter of the NUSC, or in degrading the independence and authority of the ACA?
- Does the Bill, and the process of review for which it aims to provide certainty, create scope for reconciling the government objectives of ensuring the adequate delivery of the USO and the financial stability of Telstra's competitors?

Support for the Bill

1.24 In their submissions to the Committee, Cable and Wireless Optus, Vodafone, AAPT and the industry representative ATUG gave strong support to the Bill.

1.25 Vodafone, citing the preliminary studies of the ACA's consultants, argued that Telstra's claim contained 'gross statistical, technical and financial deficiencies' and welcomed the cap 'as facilitating instead a focus on how USO arrangements overall can be improved.'[17] C&W Optus suggested that the cap would be 'consistent with industry estimates

15 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 2.

16 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 7.

17 Network Vodafone, Submission 3, pp 2-3.

of the most efficient cost of delivering USO services', enable carriers 'to seek out alternative, more efficient technologies to deliver the USO' and help 'ensure that appropriate arrangements are put in place to competitively supply the USO and make sure where competitive provision is not feasible, Telstra's USO cost claim is fully rigorous and transparent.'[18]

1.26 AAPT emphasised the importance of certainty to its business strategy:

> AAPT's success as a competitor is heavily dependent on its ability to offer competitive prices in the markets in which it competes, such as national long distance (and in the near future, local) voice and data services … we must, to remain competitive, price our services based on very low margins. At the same time, our forecasts and our ability to meet them, are subject to an intense degree of sharemarket scrutiny. Market perceptions of AAPT's performance and prospects are critical to our future success, particularly at this stage of AAPT's growth and given the newness of our public listing.[19]

1.27 Perhaps reflecting the very hostile relations between Telstra and its competitors, AAPT also claimed that:

> We believe that Telstra's claim constitutes an attempt to require AAPT and other carriers to choose between offering competitive prices and making confident financial forecasts. Because AAPT must do both to succeed, Telstra's claim therefore represents an attempt to constrain our aggressive pricing strategies and fundamentally undermine investor confidence in AAPT's stock.[20]

1.28 AAPT was also aware of the ACA's recent media release suggesting its NUSC assessment could be in the order of $425 million to $600 million. AAPT suggested that the uncertainty about the final figure, and its likelihood of still being between two and three times previous NUSC figures, 'reinforces the need for a capped amount'.[21]

1.29 ATUG stated that a significant element of the concern felt by the industry at Telstra's claim was because 'the data that was used to develop the claim was kept secret. Further, even the basis of the data and the economic principles were not disclosed.'[22]

1.30 The ACA said that its examination of Telstra's claim had been extended because of:

> A need to clarify aspects of the NUSC model and to seek further information from Telstra on its basis for deriving the data supporting its claim. There is also a requirement to ensure that the areas Telstra has claimed as net cost areas are in accordance with the areas declared by the ACA in its *Telecommunications (Net Cost Areas) Declaration No 1 of 1997*.[23]

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18 Cable and Wireless Optus, Submission 7, pp1-2.

19 AAPT Limited, Submission 11, p 2.

20 AAPT Limited, Submission 11, p 2.

21 AAPT Limited, Submission 11, p 3.

22 Australian Telecommunications Users Group, Submission 5, p 2.

23 Australian Communications Authority, Submission 9, pp 6-7.

1.31 Thus there would appear to be some grounds for industry confusion and concern about the NUSC, given Telstra's reluctance to release information about how it arrived at its figure. The Committee believes greater transparency on Telstra's part would help in the longer term to promote industry agreement and co-operation regarding the size of the NUSC and their respective liabilities.

The Government's concerns

1.32 In support of the Bill, the Government has argued that Telstra's 1997-98 USO claim has 'produced an unacceptable level of industry uncertainty and has the potential to affect the stability of the entire industry and deter investment.' They state that even though Telstra would be expected to contribute between 85-90 per cent of the assessed NUSC, 'other industry participants would face payments several times those expected for this year.' Comparing projected liabilities under the proposed cap and Telstra's claim of $1.8 billion, industry contributions would rise as follows:

- Cable and Wireless Optus from $32 million to $218 million;
- Vodafone from $4 million to $31 million;
- AAPT from $2.5 million to $ 18 million; and
- Other industry players, primarily small start-up carriers, from $1 million to $8 million.[24]

1.33 While the Government acknowledges that the ACA's final assessed figure for the NUSC is likely to be much less than Telstra's claim, it argues that it 'may still be significantly larger than $250 million' and that, in such an event, 'the stability of the telecommunications industry may be affected' and 'it will also be necessary for carriers to raise unexpectedly large amounts of funds within 28 days of the ACA providing them with its assessment.'[25]

Review of arrangements for funding the USO

1.34 In view of these medium term uncertainties, the Minister has asked the ACA to supply, with its NUSC assessment, advice as to the implications for competition of its assessment and its view on the most appropriate means of calculating the cost of fulfilling the USO. With that information available the Minister will initiate a review of arrangements for funding the USO scheme set out in Division 6 of Part 7 of the *Telecommunications Act 1997*. That review will consider:

- The most appropriate means of calculating the cost of fulfilling the USO;
- Estimates of the cost of fulfilling the USO and future trends;
- Evidence from the public or industry about the effect of the existing arrangements (including any interim solution chosen) on the industry and public benefit;

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24 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, pp 4-5.

25 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 5.

- If the ACA's assessment is considerably greater than the previously agreed costs of $250 million, options for the future USO funding arrangements taking into account the objects of the Act (ensuring USO costs are shared, promoting the long-term interests of end-users and ensuring an efficient and competitive industry);
- The long-term sustainability of arrangements for funding the delivery of the USO;
- The possibility that other carriers might fulfil the USO in future; and
- The procedures of the USO funding regime, including claims, assessment and billing processes.[26]

1.35 The Government will give significant priority to the review but suggest it is unlikely to be finalised before the end of 1999 and that any Government decisions requiring legislation would not be enacted until early 2000 – hence the proposal to extend the cap (with provision for Ministerial variation) to cover the 1998-99 and 1999-2000 financial years.[27]

Opposition to the Bill

1.36 In its submission Telstra opposed the imposition of a legislated cap in the NUSC, but welcomed the Government's announcement of a comprehensive review of USO funding. It argued that the review should be based around the following principles:

- USO cost funding and recovery should be competitively neutral;
- All industry participants should share equitably in the cost of USO provision;
- The actual costs of the USO should be taken into account when determining the USO cost, rather than forward looking costs; and
- The assessment of USO costs should be market based, such as through competitive tendering.[28]

1.37 Telstra expressed concern that the use of a Cap would inhibit moves to market-based incentives for USO delivery and that:

> It overrides established policy principles under which Telstra as the national USO provider, has made investments in regional Australia. Rather than minimise industry instability, Telstra believes that the Cap Bill will in fact lead to even greater uncertainty for investors in the telecommunications industry, as to how the costs for past and future infrastructure investments will be treated.
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> The effect of the Cap Bill is to establish a transfer of value from Telstra shareholders to other carriers, and to impose on Telstra customers, costs not incurred on the customers of other carriers. The Bill expressly limits the contribution of other carriers operating in Australia, whilst leaving Telstra's

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26 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 7.

27 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 7.

28 Telstra Corporation Ltd., Submission 10, p 1.

> liabilities open ended to continue meeting the obligation to supply and fund the USO.[29]

1.38 Telstra argued that the shortfall between the actual costs of the USO incurred by Telstra and the capped levy contributions from other carriers would have to funded from Telstra cashflows and retained earnings, and warned that:

> Telstra is concerned that the Cap bill would deny Telstra an accrued entitlement to payment in respect of the losses incurred in the supply of the USO during the 1997/98 year, which could give rise to an entitlement for Telstra to a payment by the Commonwealth under the constitutional safety net provision in Section 591 of the *Telecommunications Act 1997*.[30]

1.39 The Government has acknowledged that there is a possibility that Telstra could bring proceedings against the Commonwealth to recover funds from such an 'acquisition of property' (as set out in Clause 51(xxxi) of the Constitution). While it feels confident the legislation will not in fact amount to an acquisition of property, the Government has stated that in such an event its liabilities would be a maximum of $240.5 million, and less if the ACA determination is lower than Telstra's NUSC claim.[31] However the option the legislation implements expressly rules out such a liability and provides for no budgetary appropriation should Telstra successfully sue the Commonwealth for the shortfall.

1.40 Telstra argued that 'the outcome of the ACA's assessment should be used as the basis for compensation for the USO cost claim for the 1997-8 year, rather than an arbitrary legislated cap.'[32]

1.41 The Communications, Electrical and Plumbing Union (CEPU) supported Telstra's position here, arguing that 'the actual NUSC for the year 1997-98 … should first be determined by the ACA and then any funding difficulties should be addressed.' The CEPU also suggested that:

> A persistent undercompensation of a universal service provider for the net costs it incurs will put pressure on long term service quality and availability. In a competitive market, it is not realistic to expect a USO provider simply to absorb some or all of the costs (over and above its appropriate contribution) no matter what its level of profitability.[33]

1.42 They further suggest that:

> It is easy to take the pragmatic view, as is the case in the Second Reading Speech, that Telstra has broad shoulders and that, even if it has been undercompensated for the USO to date, the impacts on its bottom line have scarcely been devastating. What this view ignores … is the poor level of service in rural and regional areas

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29 Telstra Corporation Ltd., Submission 10, pp 1-2.

30 Telstra Corporation Ltd., Submission 10, p 2.

31 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 11.

32 Telstra Corporation Ltd., Submission 10, p 2.

33 Communications, Electrical and Plumbing Union, Submission 6, p 3.

> which has resulted from Telstra's cost-cutting in recent years. Telstra has indeed been able to absorb any unpaid USO costs without evident detriment to its financial performance. It is not possible, however, to take such a sanguine view about the implications for service quality. Someone, after all, must ultimately pay these costs and the logic of partial privatisation suggests it will not, in future, be shareholders.[34]

USO regulation dilemmas

1.43 The Consumers' Telecommunications Network (CTN), in its submission, captured some of the dilemmas facing the Government with the Bill and the subsequent review of USO funding. Firstly it stated that:

> Australian residential consumers value the provision of universal service highly and would be dismayed if cost-containment measures were found in practice to result in a lack of available funds to provide a service of acceptable equivalent quality for all Australians, particularly those in low income households, those in regional and remote areas, and people with disabilities. Therefore we would not wish a cap to be set too low.[35]

1.44 On the other hand, CTN recognised that:

> Telecommunications affordability is vital to participation in the Australian economy and community and there is a need to ensure that the price of access is affordable. To the extent that the cost of universal service provision is passed onto the consumer as an element of the costs of all services, we would welcome sensible control measures which ensured that the universal service is provided in an efficient manner. Therefore we believe it is appropriate for Government to exercise oversight and control of universal service costs in the public interest.[36]

1.45 The Western Australian Government also recognised this dilemma, arguing that there was a need to implement the USO 'in a manner that both ensures the obligation is met and is equitable to industry.' They opposed the adoption of the option proposed in the Bill (a cap for the years 1997-8, 1998-9 and 1999-2000) because:

> It would appear morally suspect to load the incumbent carrier with additional cost merely to protect the profitability of new entrants. Option 4 could be justified as a method of forcing Telstra to choose technical solutions more appropriate to remote area service delivery, but Telstra public statements indicate it would not respond in this way.[37]

1.46 The WA Government's preference, as an interim measure, was for an alternative option canvassed in the explanatory memorandum, Option 3, which provided for a legislated Cap but that the Commonwealth would fund the shortfall between it and the ACA's NUSC determination. In contrast to the explanatory memorandum, the WA Government proposed that, rather than an increase in this figure of Cap plus CPI, the formula be 'escalated at CPI

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34 Communications, Electrical and Plumbing Union, Submission 6, pp 3-4.

35 Consumers' Telecommunications Network, Submission 1, p 1.

36 Consumers' Telecommunications Network, Submission 1, p 1.

37 Department of Commerce and Trade (Government of Western Australia), Submission 8, p 2.

plus X% [they suggested 5-10%] to move the figure towards the real cost as quickly as possible and reduce the Commonwealth's financial exposure. Under no circumstances should the interim arrangement extend beyond 1999/2000'.[38]

1.47 The Government has stated that this option was not preferred because 'budget supplementation would represent a major change in policy for USO funding arrangements', could 'limit the Government's flexibility to respond to the outcomes of the planned review of USO funding arrangements', and would involve the promise of monies 'for which no provision has been made in this year's budget, nor planned for next year's budget'.[39]

1.48 The submissions by CTN, Telstra, the CEPU and the WA Government all emphasise the importance of making sure that the USO is fully funded, along with the need to align industry contributions to the real net universal service cost as soon as is feasible. While supporting the Bill in its present form, the Committee believes that such views should be given serious consideration by the Government when making decisions about the exercise of Ministerial discretion as to the cap amounts imposed in later years, and should inform the review of USO funding arrangements. These issues are given greater salience by the ACA's recent comments about the possible amount of its NUSC determination.

What is the cost of the USO?

1.49 On 21 April 1999 the ACA issued a statement announcing the release of two preliminary studies on elements of the NUSC which had been commissioned from consultants. These studies, prepared by Allen Consulting and Gibson Quai and Ovum, made recommendations about significant input values to be used by the ACA in the assessment of Telstra's claim.[40] Dr Roslyn Kelleher, Executive Manager of the ACA's consumer affairs group, stated that the ACA's preliminary analysis, using the recommended input values, indicated a possible NUSC of $600 million. If the recommendations contained in Allen Consulting's "Year 1 cost problem" report were also adopted, the amount could be as low as $425 million. However she cautioned that:

> These figures will vary in the ACA's final assessment. This is because the findings of the consultants still need to be rigorously tested and assessed and a number of aspects of Telstra's NUSC claim must be assessed, including ensuring that all the data in Telstra's claim accords with the appropriate costing methodologies and legislative requirements.[41]

1.50 These tentative estimates indicate the eventual NUSC could be significantly lower than Telstra's claim, but could also be significantly higher than the amount specified in the Bill for the cap. Telstra has stated it opposes the Bill but will accept the outcome of the

38 Department of Commerce and Trade (Government of Western Australia), Submission 8, p 3; *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 10.

39 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 2.

40 The Allen Consulting Reports are *The "Year 1" Cost Problem: Application to the USO and Proposed Solution* and *Telstra's Weighted Average Cost of Capital: Application to the USO*; the Gibson Quai and Ovum study is *ACA USO Forward Looking Technologies Study Final Position Paper*.

41 Australian Communications Authority, *Media Release: Release of Net Universal Service Cost Reports*, 20 April 1999.

ACA's assessment as the basis for compensation of the NUSC in the 1997-98 financial year.[42] Thus the amount of the NUSC cap specified in the Bill may well short-change Telstra for the costs of supplying the USO and in turn put further pressure on its ability to supply services to loss making areas. It may also arguably expose the Commonwealth to ongoing financial liabilities to compensate Telstra for the shortfall in industry contributions.

1.51 The explanatory memorandum suggests that the Government intends to fix the cap, at the very least for 1997-98, at $253.32 million regardless of the ACA's eventual NUSC determination. Thus it seems likely that Telstra will be deprived of a part of the industry contribution to the NUSC (as determined by the ACA). The Ministerial discretion to vary the amount of the cap however allows the Government some flexibility in this area.[43]

Conclusion

1.52 The Committee was persuaded by the arguments put forward by the Department of Communications, Information Technology and the Arts, and by Telstra's competitors, that this legislation is required to provide investment certainty to the Australian telecommunications industry while a more comprehensive review of USO funding arrangements is carried out.

1.53 This does not imply that the Committee has dismissed the arguments of those concerned about or opposed to the Bill. They raise a number of issues that the Committee feels the Government could consider as it conducts the review of USO funding arrangements and considers the exercise of Ministerial discretion the legislation provides.

1.54 The choice of Option 4, which does not provide for Commonwealth funding of a possible shortfall produced by the Cap, may still not protect the Commonwealth from liability. Possible legal action by Telstra to recover this amount may in turn require the Commonwealth to compensate the universal service provider for the 1997-98 shortfalls, if not those of the remaining years covered by the legislation. Alternatively the legislation provides the Minister with discretion to vary the cap, while the WA Government's suggestion that the cap be raised to quickly match the true NUSC could be a way of limiting the Commonwealth's liability and limiting the tenure of the discrepancy.

1.55 It is an important matter of public interest that a credible and accepted costing model for the USO, and an agreed structure for industry contributions to the NUSC, be finalised as soon as possible. When this is in place, the principle that the universal services provider(s) should be properly compensated for the NUSC can be reconciled with the other significant goals of competition and industry viability. Likewise the regulatory and funding arrangements for the USO can move closer to the ideal of broad industry agreement and cooperation, and assuage concerns about the ACA's independence. It will also help to isolate the USO from ongoing industry dispute over the terms of interconnection and trade practices.

1.56 In expressing its support for the Bill, the Committee notes that there is virtually unanimous support for the planned review of the USO funding arrangements and that all players and affected groups will be able to provide input to it. The size of Telstra's claim

42 Telstra Corporation Limited, Submission 10, p 2.

43 *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999 Explanatory Memorandum*, p 2.

(three times the ACA's possible determination, and many times the amounts for previous years) and the uncertainty surrounding the results of the new Bellcore costing model, justifies an interim measure to provide certainty through the process of the USO funding review.

1.57 Another factor sowing confusion has been Telstra's reluctance to reveal (to not only the industry, but also the ACA) the financial assumptions upon which it based its claim. Likewise the vulnerability of other carriers to significant financial damage, should their NUSC contributions suddenly escalate beyond their capacity to absorb them and remain competitive, is further justification for the measure. For these reasons the Committee recommends the passage of the *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999* in its current form.

Recommendation

The Committee recommends that the *Telecommunications Laws Amendment (Universal Service Cap) Bill 1999* proceed.

Senator Alan Eggleston

Chair