

PRODUCTIVITY COMMISSION USO ISSUES PAPER – VOCUS SUBMISSION

Vocus is pleased to provide its views on the important issue of the Universal Service Obligation (USO) policy, its rationale, objectives and policy options. The USO has been instrumental in providing ubiquitous standard voice, emergency and pay phone services, particularly to rural and remote Australia. Vocus supports this social policy objective of providing all Australian's with access to fundamental services, however, the changing demands of end users and technology shifts in the market has over time seen a move away from the standard voice service.

Vocus contends that the key issue is how best to achieve the fundamentals of the USO policy objectives in the context of competing technologies, networks and existing Commonwealth programmes to provide access to universal services as well as broadband services.

Rationales, objectives and factors influencing policy options for USO

The Plain Old Telephony Service (POTS) provided over a copper-based PSTN line is no longer the predominant form of communication in today's market. Over the past two decades there has been a steady transition to high capacity fixed line (via xDSL, Fibre and HFC technologies) and wireless services (via 3G/4G, WiFi and Fixed LTE technologies), in both the consumer and business sectors.

In fact the consumer trend is to forego the traditional fixed-line voice service in favour of mobile services and data-only fixed broadband services. Traditional voice calls as a percentage of total communications has been steadily falling and is progressively becoming a smaller proportion of the total. The time where a fixed-line voice service in the home is the only mode of communication has long gone.

The evolving market demand has seen the underlying telecommunications infrastructure constructed in such a way as to cater for both voice and high capacity data, with data services dominating voice in terms of utilisation. Voice is progressively being provided as an Internet Protocol (IP) stream as an Over The Top (OTT) service, replacing the traditional PSTN service. Vocus believes this trend should be reflected in any future USO policy implementation.

The Productivity Commission's own research clearly points to a dramatic reduction in the utilisation of fixed line and payphone services. This trend is only set to continue into the future.

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One such example of the decline in the utilisation of these core USO services is evidenced by Telstra's use of the existing payphone infrastructure as part of its national WiFi network deployment. Clearly Telstra has identified a more productive use for this infrastructure than its original design.

This however begs the question of the appropriateness of the use of USO funded infrastructure for private purposes?

A. Changes in today's telecommunications market and productivity gains

Productivity gains by end users, be they consumers, businesses or governments, are predominantly derived contemporarily and in the future through access to data services and not to traditional voice-based services such as facsimiles. The Internet has progressively become the prime medium by which these sectors trade and interact. Teleworking, video conferencing and online shopping are a few of the examples where data centric communications has provided for significant gains in speed and efficiency.

A 2012 OECD report¹ on the economic impacts of the Internet had this to say about productivity gains through advances in telecommunications technologies.

"The Internet significantly affects OECD economies at different levels and in numerous different impact areas. In particular the Internet impacts firms in various sectors, individuals and governments. It also has some observable general macro-economic effects.

At the firm level, the restructuring of business models in association with use of the Internet has led to improved efficiencies. The impact of the Internet can also be seen in the rapid growth of new firms founding their businesses on the Internet. The Internet's enhanced communication capabilities are affecting nearly all sectors of the economy in ways that may be as subtle as making previously hard-to-find data available online or as profound as transforming an entire market such as is occurring with music, video, software, books and news.

The Internet is reshaping the way individuals live. It brings benefits of higher consumer welfare (through a larger variety of digital goods and services, lower prices, improved information gathering, more distribution channels and so forth). In addition, individuals benefit from a more efficient labour market and, on a broader level, from positive impacts on the environment and in education.

For governments, Internet development enables better communication with citizens, industry and other organisations. The Internet has also helped governments run more efficiently via improved information sharing, increased transparency and the automation of various resource-intensive services."

¹ June 2012 OECD Report - The impact of the Internet on OECD Countries.

Future policy to improve productivity should be biased toward data and the Internet and not on traditional voice technologies.

B. Market Distortion

Vocus, as a significant investor in the telecommunications market is very conscious that any market distorting influences will have impact on investment decisions. The funding for the USO is one such distortion that has the result of stifling competitive entry into the very markets that the USO is set to address.

The provision of funding that is above efficient costs to the incumbent provider has the impact of entrenching that provider's dominance in that market. Any margin collected can be used to cross-subsidise and squeeze out competitive entry.

A recent CIE report² had this to say about inefficient government subsidies.

"Telstra has historically received, and continues to receive, subsidies such as the Universal Service Obligation and NBN Co agreement.

- *Telstra has not used these subsidies to provide lower prices for Australian consumers*
- *Instead, these subsidies have allowed Telstra to entrench its market dominance"*

A fundamental distortion to the economic returns that a provider may expect to receive in a given market has the effect of stifling investment by either the incumbent or the entrant thereby breaking down the ladder of investment principles. This results in the competitor never entering the market and ultimately results in the consumer suffering the consequences of this lack of competitive entry (e.g. inferior services and/or above normal prices).

Mr Ian Martin³ in a recent statement to clients had this to say about the long-term risks to the industry.

"We consider the key to long term sector value growth and reduction in investor risk likely turns on establishing a resolution to rural communications issues, including the level of USO cost and the level and structure of subsidy. Rural services are likely to turn more heavily on mobile network coverage and service development than the fixed line NBN per se but have implications for NBN's backhaul service provision and CVC pricing"

² June 2015 CIE Report – Australian Telecommunications Market Structure: The price premium paid by consumers

³ Industry consultant Ian Martin statement to clients – exert from Communications Day, 14 July 2016

It is Vocus' view that there actually is no net cost of providing the USO. The cost of providing this service is already recovered through the fees charged to end-users. By providing additional funds to the USO provider is a further distorting effect on the market and hence is unnecessary and counter-productive.

Funding for USO, double dipping and alternative models for USO

Vocus is of the view that the Commonwealth is already providing significant funding that will effectively provide a replacement platform to provide the basic voice service that the USO is designed the cover.

Through a combination of the NBN rollout and the Mobile Black Spots programme the Commonwealth will have achieved the network coverage and capability to offer an equivalent, if not superior service to what is currently being provided through the USO.

Tens of billions of dollars will have been invested in order to complete these national infrastructure initiatives. There does not seem to be a strong rationale to continue to pour in additional Commonwealth and industry funds in order to run a parallel network.

From 2020, when the NBN is fully deployed, to the end of the current USO period the Commonwealth will be spending in the vicinity of \$1.2B. Funds that could be better directed elsewhere.

Vocus suggests that a new funding structure be adopted for the USO that makes better use of available and deployed funds, better serves the needs of the consumer and better supports competition in the supply-side markets.

To this end Vocus contends that the Commonwealth already possesses the fundamental programmes and is deploying the infrastructure that have the capacity to satisfy its obligation to provide a standard voice service to all Australians.

The focus in regional and remote Australia should be on the provision of wireless services (via fixed LTE, 4G mobile and satellite) in order to satisfy the USO. Over the last few years the industry has seen significant network expansion by the incumbent mobile providers that is resulting in more and more of the Australian population being covered and having access to quality mobile services (voice and data).

Coverage gaps are being adequately filled by the Commonwealth's Mobile Black Spots programme, which has already seen significant new and planned deployments to geographic areas that either have no mobile coverage or limited coverage.

A co-funded model where the Commonwealth and private enterprise each contribute to the deployment is perhaps a more appropriate funding construct as it better reflects that costs of provision and considers the need for achieving economic returns in a competitive environment.

Other policy issues – impact of NBN

The NBN is well placed to provide the standard voice service in all other regions and being a wholesale only provider will allow for competition at the retail end, which will benefit the end user through price, service and operational competition. The current USO model does not allow for this as the total funding is provided to the incumbent provider.

The USO policy should be reframed on a consumer rights basis. Any required top up funds to be supplied by the Commonwealth should be targeted at the consumer (e.g. via low income or disability subsidies, etc.). This funding should be reasonable, efficient and equitable.

If the underlying objectives of the USO can be met in whole by existing initiatives a strong case can be made for not having a standalone USO construct.

In Summary

Vocus is a strong advocate for competition being the best way to ensure sustainable outcomes. As such Vocus believes any future USO policy should be designed to deliver its objective of providing standard telephone and payphone services to all Australians through competitive supply.

Vocus suggests that the objectives of the USO can adequately be met through existing telecommunications initiatives (i.e. the NBN and the Mobile Black Spots programme). There is no need to separately fund the USO under its current structure.

Vocus contends that there is actually no net cost in providing the USO in the first place and providing additional funds to the incumbent provider would be market distorting and counter-productive.

Scrapping the existing USO from 2020 to the end of the current period will benefit the Commonwealth in the order of around \$1.2B.

The Commonwealths focus should be on providing a standard voice to rural and remote through wireless technologies rather than fixed infrastructure, as this would be more cost effective and flexible mode of delivery.

Vocus suggests that if any Commonwealth funding support is required it should be targeted toward the consumer through socially based subsidies rather than providing a blanket subsidy to the incumbent telecommunications provider.

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