

ST, a.s. views on the
Universal Service Regime

for the fully liberalized telecom market

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Agenda

- 1 Scope and purpose of Universal Service Obligations
- 2 Determination of affordable prices
- 3 Comparison Slovakia - EU
- 4 Tariff Re-balancing
- 5 Universal Service Deficit
- 6 Financing USO

1 Scope & purpose of USO

Definition:

Universal Service is

- a minimum set of services
- available for the public
- within the entire national territory
- at an affordable price

1 Scope & purpose of USO (cont'd)

- **US as a minimum set of services**
 - Access as part of USO: Only basic PSTN services to be included
 - Payphones: less demand as mobile penetration grows
- **US as an affordable service**
 - Affordability depends on household income
 - Only needy people as USO-beneficiaries

2 Comparison Slovakia – EU

	Slovakia	EU
• Income per employee	≅ 500 €	∅ ≅ 2200 €
• ∅ Residential monthly telecom expense		
→ access line rental	< 5 €	∅ ≅ 15 €
→ call conveyance	< 5 €	∅ ≅ 27 €

2 Comparison Slovakia – EU (cont'd)



	Slovakia	EU
• Split rural / urban	Bratislava: → 50% of revenue → 25% of access lines → 2 % of territory	
• telephone penetration (% of population)		Germany: 45 %
→ fixed	32 %	
→ mobile	29 % (Nov. 2001)	

2 Comparison Slovakia – EU (cont'd)



The role of MNOs

- Rapid growth of mobile penetration
 - October 2000: 20 % of Slovak population
 - November 2001: 29 % of Slovak population
 - Revenues from mobile services
 - > Revenues from fixed voice telephony in 2002
 - Pre-paid = fastest growing segment
 - Substitution of fixed access by mobile access
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3 Determination of Affordable Prices



- Danger:
 - Extension of USO burden by politics, ...
 - ... de facto exclusively at the cost of profitable ST customers
- Requirement: Affordability to be periodically reviewed
 - Upward trend in household income

4 Tariff re-balancing

- Typical initial incumbent situation:
 - Access lines cross-subsidized at cost of call conveyance
 - Economic pressure on ST to re-balance tariffs
- But: Scope for raising access line rentals politically restricted

4 Tariff re-balancing (cont'd)

- Also economic restrictions:
 - **Substitution of fixed access lines by pre-paid mobiles**
 - MNOs make money on fixed-to-mobile call termination
 - Access network subject to economies of scale
 - Per unit cost of serving remaining fixed access customers raised

5 Universal Service Deficit

- **Universal Service Deficit**

- Definition: incremental revenue \div incremental cost
- Incremental revenue from also includes:
 - revenues from incoming calls on access lines
 - Intangible benefits (marketing advantages etc.)
- relates only to “unprofitable customers”

- **Access Deficit**

- only revenues from access line rentals considered
 - relates to the Access Network in total
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5 Universal Service Deficit

ST's access deficit significant

- Slovak access line rentals much lower than EU standards
- Indirect revenues from access line provision practically zero
 - Incoming calls on residential access lines negligible
 - Only Top-10 residential customers attractive for ST competitors
 - Intangible benefits irrelevant in the mass market

5 Universal Service Deficit (cont'd)



ST's access deficit significant

- Labour is cheaper than in Western EU countries
- But: Access network is CAPEX-intensive
 - Thus lower labour costs do not pay off significantly
 - In turn, cost of capital higher than in Western EU countries

6 Financing USO

Slovak Telecommunications Act:

→ Only operators with less than **80%** market share qualify for USO funding

No way to justify the “80 %”-rule!

- (1) Rule designed to impose USO burden exclusively on ST
- (2) But mobile telephony is a huge cash generator

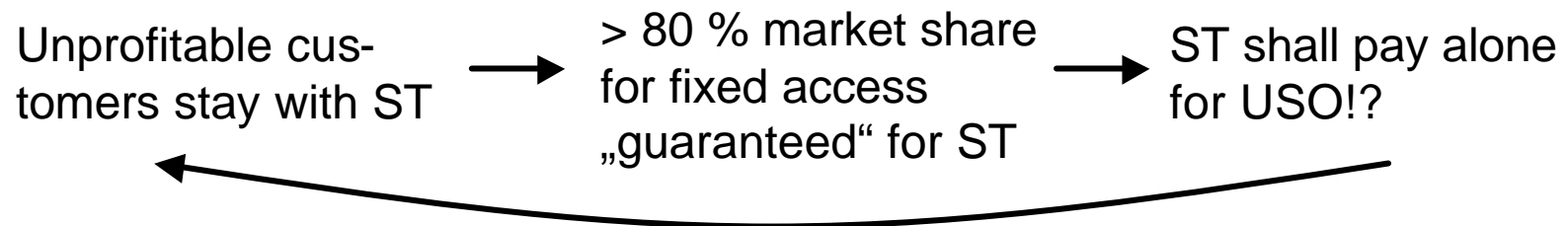
6 Financing USO (cont'd)

No way to justify the “80 %”-rule!

(3) ST's revenue stream is highly vulnerable

- Only business segment + top-10 residentials economically interesting
- less than 10% of customers generate more than 50 % of revenue
- ST competitors lobby intensively for Local Loop Unbundling

(4) USO as a “doom loop” for ST?



6 Financing USO (cont'd)

Overview on funding methodologies:

- Governmental funding
- Universal service fund
- Surcharges on interconnect call rates (“Access Deficit Contributions”)

6 Financing USO (cont'd)

Governmental Funding

- Society, and not dedicate groups would pay
 - appropriate, as USO is element of public social policy
- Competitive neutrality assured
 - no cost burden imposed on specific carrier
- Right incentives to politics provided
 - politics internalise cost of extending USO obligations
- But: **Is it also realistic?**

6 Financing USO (cont'd)

Universal Service Fund

- Financial burden shared within industry
 - Only profitable telecom customers bear USO cost
- EU regulation: Individual levies dependant on market shares
 - Guideline: No distortion of competition by USO-levies
 - Thus: USO levies to be related to ability to pay
 - **Problem: How to define the relevant market?**

6 Financing USO (cont'd)

- Possible solution: Scoring of customers
 - Score according to customer's economic attractiveness / profitability
 - Profitability can be approximated by revenue per customer
 - USO levy shall be dependant on score
- Advantages:
 - Undertaking's contribution depends on its ability to pay
 - Ability to pay = accepted principle in income taxation
 - Minimal distortion of competition (given US-fund is prevailing)

6 Financing USO (cont'd)

Access Deficit Contribution

- ADC = surcharge on IC call rates
- Rejecting ADC on grounds of new Universal Service Directive?
 - Slovak Telecommunications Act to be amended
 - Ministry refused to take new EU framework into account
 - Argument presented: Effectiveness of new framework not before 2003
 - ST favoured legislation on grounds of EU framework
 - **Why than denying ADC on grounds of new EU framework?**

6 Financing USO (cont'd)

- **ST recognizes economic arguments against ADC**
 - Distortion of make-or-buy decisions etc.
 - ST would be main-payer even under ADC-regime
- **ST regards ADC as possible interim solution**
 - Establishment of scoring system will take some time
 - ADC-payments related to demand for IC-calls
 - But demand for IC-calls not related to profitability of customer-base