

**For information
on 18 July 2007**

**Legislative Council Panel
On Information Technology and Broadcasting

Review of Regulatory Framework
for Universal Service Arrangements**

Purpose

On 28 December 2006, the Telecommunications Authority (TA) issued a consultation paper entitled “Review of Regulatory Framework for Universal Service Arrangements”. A total of seventeen submissions were received. Having duly considered the submissions, the TA has concluded the review and issued a Statement on 8 June 2007 informing the industry and the public on the changes of the regulatory framework for universal service arrangements. An executive summary highlighting the main conclusions of the TA is given in Annex 1. This paper gives Members a brief account of the salient issues.

Background

2. Basic telephone service is considered essential for everyone in Hong Kong. It underpins social and economic activities for all walks of life. Hence, a universal service obligation (USO) regulatory framework has been put in place to ensure that basic telephone service is available and affordable to all people in Hong Kong irrespective of where they reside or carry on business.
3. Section 35B of the Telecommunications Ordinance (Cap. 106) (the Ordinance) empowers the TA to require one or more fixed carrier licensees to have a USO to ensure that a good, efficient and continuous *basic service* is reasonably available to all people in Hong Kong. The definition of basic service is given in Annex 2.
4. Section 35B of the Ordinance also empowers the TA to establish a system for prescribed licensees to meet a reasonable contribution to the net cost of providing the USO.

The Past Arrangements

5. USO regulatory framework was established in 1998 and subsequently updated in 2000. So far PCCW-HKT Telephone Ltd. (PCCW) is the only universal service provider and compensated under the Universal Service Contribution (USC) scheme for the net cost of providing universal service to unprofitable customers.

6. The TA prescribed that carriers and service providers providing external telecommunications services (ETS) over the Public Switched Telephone Network (PSTN) should be the contributors for funding the cost of USO. The cost sharing is based on the ETS traffic volume (i.e. IDD minutes) carried by the contributing operators. For 2004, the USO cost was \$103.3 million.

Need for Review

7. With the advent of voice over Internet Protocol (VoIP) and improved quality of service and high penetration of broadband Internet access, increasing volume of international calls has been made through the Internet instead of the PSTN, thereby bypassing the USC sharing mechanism. As a result, the funding arrangement based on IDD traffic over the PSTN may not be sustainable in the longer term.

8. The sharing of USO cost on the basis of IDD traffic volume was due to historical reason. In the past, IDD services enjoyed high profit margins and they were the natural candidate chosen to subsidize the loss-making local telephone services. With the rebalancing of the local services completed in 2001, the legacy of cross-subsidy between local and IDD services has been rectified. As the profit margins generated by ETS are on the decline, the past reason for funding the USO by operators providing IDD services may become inapplicable.

9. As competition develops, the reason for designating a USP in areas (or buildings) connected by other fixed self-built customer access networks may diminish. Currently more than 76% of the households in Hong Kong have a choice of telephone services supplied over these alternative customer access networks. If PCCW still receives subsidy or compensation for providing basic services in these areas, then it may not be fair to other fixed network operators who are competing with PCCW in these areas.

10. Similarly, there are choices at certain places for public payphones. There are arguments that the importance of payphones has diminished in recent years.

11. The scope of USO includes the services for receiving announcement of weather warnings on tropical cyclones, thunderstorm, heavy rain, and flooding over the phone. However, similar services are provided by the Hong Kong Observatory.

The New Arrangements - Salient Issues

12. The TA, having duly considered the submissions, updates the regulatory framework for USO and the details are given below.

Scope of universal service

13. In line with the views of most of the respondents to the consultation paper, the current scope of universal service will be maintained but with the following changes:

- The weather warning services (Items (f), (g) and (h) of the “basic service”) will be taken out of the scope of the universal service when the opportunity to amend section 2 of the Ordinance arises.
- The “relevant revenue” should take into account the fair market value of using the payphone kiosks for advertising and any other purposes other than payphone service, and the total amount (or value assessed) should be accounted for as relevant revenue in calculating the USC. The fair market value should be assessed by the TA, or with the help from an independent consultant, if necessary.
- A mechanism will be introduced for the TA to direct additions to, or removal from, the list of payphones eligible for USC after consultation with PCCW (the universal service provider) and the community.

USC for Areas with Alternative Fixed Network Coverage, and USC for Payphones in the Vicinity of Competitive and Alternative Service

14. The fair USC for areas (or buildings) connected by at least one

alternative self-built fixed customer access network capable of providing basic telephone service should be zero. In other words, PCCW will not receive any compensation for provision of basic telephone service in these areas. All respondents (except PCCW) are supportive of this arrangement.

15. Similarly, the fair USC for PCCW's payphones in the vicinity of competitive and alternative payphone service should be zero. All respondents (except PCCW) agree that PCCW should not receive any compensation for operating a payphone where there is alternative payphone service in the vicinity. However, before reducing the USC for a payphone of PCCW to zero, the TA will consult relevant parties and consider whether:

- payphone service provided by competitive provider(s) is available nearby (within a walking distance of 100 metres);
- the payphone in question is next to other payphone(s) of PCCW; and
- there is a genuine public need of that public payphone (including whether peak demand at the location concerned justifies the provision of multiple payphones).

The Aggregation Basis

16. The current approach to measure net cost for USO is on a customer-by-customer basis. There have been criticisms against using this methodology from investment, international practice and competition angles as this methodology would over-estimate the cost for meeting USO.

17. The TA considers that sound investment decision associated with network and service rollout would be based on "area" basis instead of "customer-by-customer" basis. Most submissions (except two submissions including that of PCCW) agree to the view. It is fair to both PCCW and its competitors to calculate USC on "distribution points" basis as all fixed network operators have similar obligations to provide their services at locations where the services could be reasonably provided. The TA therefore concluded that the aggregation basis should be changed from "customer-by-customer" to "distribution points" for USC calculation purpose.

Funding Arrangements for Universal Service Obligation

18. The *status quo* on the sharing of the cost of USO on the basis of IDD traffic volume handled should continue for the time being. The sharing basis will be migrated by end of April 2009, when the current regulatory intervention in fixed-mobile interconnection charge is withdrawn, to that of the number of all telephone numbers allocated. This is considered to be a fair and sustainable arrangement as all users of the local telephone services (fixed or mobile, including IP telephone services) would share the cost of the USO.

Way Forward

19. The updated regulatory framework is effective from 1 July 2007 unless stated otherwise. The Office of the Telecommunications Authority will coordinate with the industry to implement the changes.

Office of the Telecommunications Authority
11 July 2007

Review of the Regulatory Framework for Universal Service Arrangements

Statement of the Telecommunications Authority

8 June 2007

Executive Summary

S1. The Telecommunications Authority (TA)'s conclusions as a result of the Consultation on the Review of the Regulatory Framework for Universal Service Arrangements are summarized below:

Universal Service Arrangements

S2. The universal service arrangements will be maintained.

Scope of Universal Service

S3. The current scope of universal service will be maintained but with the following changes:

- The weather warning services (Items (f), (g) and (h) of the “basic service”) will be taken out of the scope of the universal service when the opportunity to amend section 2 of the Telecommunications Ordinance arises.
- The “relevant revenue” should take into account the fair market value of using the payphone kiosks for advertising and any other purposes other than payphone service, and the total amount (or value assessed) should be accounted for as relevant revenue in calculating the universal service contribution (USC). The fair market value should be assessed by the TA, or with the help from an independent consultant, if necessary.
- A mechanism will be introduced for the TA to direct additions to, or removal from, the list of payphones eligible for USC after consultation with the universal service provider (USP) and the community.

USC for Areas with Alternative Fixed Network Coverage, and USC for Payphones in the Vicinity of Competitive and Alternative Service

S4. The fair USC for areas (or buildings) connected by at least one alternative self-built fixed customer access network capable of providing basic telephone service should be zero.

S5. Similarly, the fair USC for payphones in the vicinity of competitive and alternative service should be zero. Before reducing the USC for a payphone to zero, the TA will consult relevant parties and consider whether:

- payphone service provided by competitive provider(s) is available nearby (within a walking distance of 100 metres),
- the payphone in question is next to other payphone(s) of the USP, and
- there is a genuine public need of that public payphone (including whether peak demand at the location concerned justifies the provision of multiple payphones).

Relevant Revenue and Cost under Competition

S6. The existing treatment of USP's discounts to its customers should continue in the USC calculation.

The Aggregation Basis

S7. The aggregation basis should be changed from "customer-by-customer" to "distribution points" for USC calculation purpose.

Funding Arrangements for Universal Service Obligation (USO)

S8. The *status quo* on the sharing of the cost of USO on the basis of IDD traffic volume handled should continue for the time being. The sharing basis will be migrated, by end of April 2009 when the current regulatory intervention in fixed-mobile interconnection charge is withdrawn, to that of the number of all telephone numbers allocated.

Administration Matters

S9. An intermediary will continue to be engaged when USC funding is based on IDD traffic handled. The USP should take up the role of USC billing and collection from May 2009 when the USC funding is based on the number of all telephone numbers allocated.

S10. The accumulated unclaimed USC rebate to universal service contributors should be used to reduce the level of the USC.

S11. The conclusions of this Consultation will be implemented from 1 July 2007 unless stated otherwise.

Definition of Basic Service

The scope of universal service is referred to as “Basic service” in the special conditions of various telecommunications licences and defined in section 2 of the Ordinance:

- (a) a public switched telephone service including the service connection, continued provision of connectivity, provision of a dedicated telephone number, an appropriate directory listing (except where the customer otherwise directs), a standard telephone handset without switching capacity listing (except where customer elects to provide the handset), standard billing and collection services and relevant ancillary services and facilities necessarily utilized by the licensee;
- (b) a reasonable number of public payphones including payphones located within publicly or privately owned facilities to which the public have access, whether on a 24 hour basis or restricted to certain hours or days of the week;
- (c) a reasonable number of public payphones, designed for ease of effective use by the hearing impaired;
- (d) a reasonable number of public payphones, designed for access by the physically disabled, including but not limited to those persons using wheelchairs;
- (e) operator provided directory enquiries, fault reporting, service difficulty and connection services;
- (f) a tropical cyclone warning service (recommended to be taken out);
- (g) a thunderstorm and heavy rain warning service (recommended to be taken out);
- (h) a flood warning service (recommended to be taken out);
- (i) access to a number or numbers for emergency services; and
- (j) such other services, subject to the Ordinance, as the Authority may include.