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COMMUNICATION FROM THE COMMISSION

on

Assessment Criteria for National Schemes for the Costing
and Financing of Universal Service in telecommunications
and Guidelines for the Member States on Operation of such
Schemes

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1. INTRODUCTION : THE PURPOSE OF THIS COMMUNICATION

This Communication is intended to inform the Member States on the criteria which the Commission will use in assessing under Community law provisions relating to the costing and financing of universal service within national schemes for universal service ("National Schemes").

No requirement is imposed on Member States to set up National Schemes to share any financial burden resulting from the cost of universal service provision amongst market players.

However, where such schemes are implemented they must be compatible with Community law, and in particular, with Commission Directive 96/19/EC of 13 March 1996 amending Commission Directive 90/388/EEC regarding the implementation of full competition in telecommunications markets ("the Full Competition Directive") and with the provisions endorsed by the Council and European Parliament in the proposed Council and European Parliament Directive on Interconnection¹ ("the Interconnection Directive").

National Schemes must necessarily be adapted in the light of the specific conditions in the Member States, particularly the conditions in less developed regions within the Community. At the same time, the underlying principles for costing and financing universal service within those schemes should be the same throughout the Community, even though the costs eventually calculated may be closely related to the prevailing economic, social and geographical conditions. This Communication also provides guidance on principles for the operation of National Schemes.

According to the Full Competition Directive National Schemes must be notified to the Commission. This Communication therefore identifies in Sections 2 and 3 the legal principles and approaches which the Commission expects to find in National Schemes notified to it, if such schemes are to be judged to be compatible with the Community legal framework. It also in Section 4 examines those aspects of universal service which are primarily addressed at a national level. In Section 5 provides additional detail in the form of Guidelines for National Regulatory Authorities as to the operation of national schemes for universal service in the area of telecommunications.

This Communication does not create enforceable rights. Moreover, it does not prejudice the final assessment of National Schemes notified to the Commission. That assessment will necessarily take into account the situation prevailing at the time of notification of National Schemes.

¹ COMMON POSITION (EC) No 34/96 adopted by the Council on 18 June 1996 with a view to adopting Directive 96/.../EC of the European Parliament and of the Council of ... on interconnection in telecommunications with regard to ensuring universal service and interoperability through application of the principles of open network provision (ONP).

2. BACKGROUND

2.1 The definition, scope and financing of Universal Service

The concept of universal service will play an important part in meeting the challenges of the Information Society². It is based on the principles of universality, equality, continuity and affordability.

Universal Service is defined in the Interconnection Directive as:

“a defined minimum set of services of specified quality which is available to all users independent of their geographical location and, in the light of specific national conditions, at an affordable price”.

In March of this year, the Commission indicated that that defined service equates to *“the provision of voice telephony service via a fixed connection which will also allow a fax and a modem to operate, as well as the provision of operator assistance, emergency and directory enquiry services (including the provision of subscriber directories) and the provision of public payphones”*³.

It also indicated that according to Directive 95/62/EC⁴ (the “Voice Telephony Directive”), *“Users should also have access to published information about the cost and prices of services, about their quality and whether targets for quality are being met”*.

Finally, the Commission stressed in that Communication that universal service was a dynamic and evolving concept and that it would be kept under regular review, particularly, with regard to its scope, level, quality and affordability within the European Union. The Commission is due to report for the first time by 1st January 1998. In this context, the question of possible financing of preferential tariffs for access to Internet type networks by schools as mentioned in the Action Plan “Learning in the Information Society”, adopted by the Commission last October, could also be considered. One initial important evolution is found in the recent proposal for a European Parliament and Council Directive which adapts the Voice Telephony Directive to a competitive environment⁵. This proposal, for example, no longer equates universal service with access solely via a fixed line, but rather with provision of a defined service to a fixed location, allowing delivery via a fixed line or a wireless connection. This recognises the role of wireless delivery to fulfil universal service obligations where this is the least costly technology.

² See Commission Communication of 13 March 1996 on universal service in the perspective of a fully liberalised environment, COM(96) 73 and Commission Communication on general interest services in Europe, COM(96) 443.

³ See Communication of 13 March 1996 on Universal Service for telecommunications in the perspective of a fully liberalised environment, COM(96) 73.

⁴ Directive 95/62/EC of the European Parliament and of the Council of 13 December 1995 on the application of open network provision (ONP) to voice telephony, OJ L321, 30.12.96

⁵ Proposal for a European Parliament and Council Directive on the application of open network provision (ONP) to voice telephony and on universal service for telecommunications in a competitive environment, COM(96) 419, 11.9.96.

The net cost of such universal service obligations may, where it represents an unfair burden on the organisation providing universal service, be shared amongst other market players. Section 2.3 below provides an overview of Community law applying to the costing and financing of universal service.

2.2 Policy aims underlying the financing of universal service

National schemes for financing universal service should be consistent with certain basic policy aims at a European level. Such schemes must, as far as possible:

- minimise market entry barriers, whilst providing adequate guarantees for the financing of universal service.
- respect the need for neutrality (*e.g. between particular market players / particular technologies or between integrated or unbundled provision of services*) in order to avoid distorting the pattern of market entry or subsequent investment decisions and/or market activity.
- keep any administrative burden and related costs to a minimum
- be based on objective, transparent, proportional and non-discriminatory procedures, and
- create an environment which stimulates greater efficiency and innovation in order to ensure the delivery of universal service at a lower cost over time.

Whilst Member States remain free, in line with the principle of subsidiarity to set additional obligations relating to particular technologies and facilities and/or to set service and coverage targets (e.g. for Mobile Services or for ISDN), any financial burden associated with their provision may not be funded out of the mechanism established for financing universal service.

2.3 The decision whether or not to create a National Scheme to fund the net cost of universal service in a Member State

In line with subsidiarity, the National Regulatory Authority is free to determine on the basis of the audited costs of universal service, that :

- Universal service financing is not required, either because universal service obligations do not result in a net cost, or that either (i) the net cost established does not represent an unfair burden for the operator(s) concerned or (ii) it does not justify the administrative costs of a specific financing scheme.
- Universal service obligations do represent a burden, but the State chooses to finance it directly or indirectly.
- Universal service obligations are considered a burden and that a specific universal service financing scheme is required. In such a case the National Schemes **must** be in accordance with Community law.

2.4 Relevant Community law applying to the costing and financing of universal service

The general principles and policy aims set out above are derived from the current framework for costing and financing universal service (*See Annex A for legislative references*). That framework imposes specific obligations on the Member States.

2.4.1 *The Full Competition Directive*

According to the Full Competition Directive, Member States are required to notify to Commission no later than 1 January 1997 any licensing or declaration schemes aimed at compliance with "*financial obligations with regard to universal service*"⁶. These schemes must be published by the Member States no later than 1 July 1997 and before they are implemented the Commission must "*verify the compatibility of these drafts with the Treaty*" (Article 3). This process of verification by the Commission will therefore take place during the early part of 1997.

The criteria which such schemes must follow are set out in Article 4C of the Directive. These permit Member States to make use of either a universal service fund or a system of supplementary charges. The approach chosen can apply only to undertakings providing public telecommunications networks and must "*allocate the respective burden according to objective and non-discriminatory criteria and in accordance with the principle of proportionality*".

Finally, the Commission is also required to review such universal service schemes no later than 1 January 2003 to assess whether the schemes in place "*limit access to relevant markets*".

2.4.2 *The Interconnection Directive*

The proposed Interconnection Directive will set out a framework which goes beyond the principles found in the Full Competition Directive. Whilst the latter directive identifies obligations flowing from the Treaty with regard to universal service, the Interconnection Directive builds on those principles to propose a common, harmonised framework for the costing and financing of universal service within the Member States.

According to Article 5(1) of the Interconnection Directive, Member States may establish mechanisms for sharing the net cost of universal service with other organisations "*operating public telecommunications networks and/or publicly*

⁶ Where universal service schemes are put in place other than via a licensing or declaration procedure, Article 4C of the Directive requires Member States to notify any national scheme to share the net cost of the provision of universal service obligations for verification with the Treaty. In this case, such schemes must be notified by 11 January 1997 rather than the slightly sooner date set for licensing and declaration procedures.

Later dates for notification may apply to those Member States to which the Commission grants additional transitional periods in respect to opening up of their markets to competition. Notification dates in those cases will be set out in the decision granting the additional transitional periods. Where Member States do not immediately create National Schemes for universal service, but do so at a future date, the Commission would expect such schemes to be notified to the Commission in order to allow an assessment of their compatibility with Community law in good time before their entry into force.

available voice telephony services". In common with the Full Competition Directive contributions must be determined in an objective, transparent, non-discriminatory and proportional manner.

Article 5(2), in common with the Full Competition Directive, envisages either an independent universal service fund at a national level or a system of supplementary charges in addition to interconnection payments.

Only the fixed public telephone network and fixed public telephony services as identified in Section 2.1 above (i.e. Annex I Part 1 of the Interconnection Directive) can be financed via a universal service financing mechanism⁷.

The Interconnection Directive provides (Article 5(3) and Annex III) principles for calculating the net cost of universal service. That net cost represents "*the difference between the net cost for an organisation of operating with universal service obligations and operating without the universal service obligations*". It requires these calculations to be made available to National Regulatory Authorities on request and for those calculations to be audited by the National Regulatory Authority or other competent body, with the results being made public.

National Regulatory Authorities are required to assess whether a specific financing mechanism is justified, taking account of the market benefit which accrues to the organisation providing universal service (Article 5(4)).

Finally, procedures for cost sharing and the mechanisms used should be open to the public. National Regulatory Authorities should also publish on an annual basis a report giving the cost of universal service and the contributions made by all the parties involved (Article 5(5)).

2.4.3 *The role of state aids*

Where Member States decide to fund, directly or indirectly through the State budget, part or all of the net cost of universal service in the telecommunications sector, such interventions must be made in a manner which is consistent with the EC Treaty's rules on State Aids which are set out in Articles 92 to 94 together with Article 90. Such funding should be transparent and should not exceed the net costs of the obligations calculated in line with guidelines provided in this Communication. In cases where it will be soundly established that there is no overcompensation (eg. when there is no compensation of costs which should normally be borne by the relevant activity) of the cost of public service, there will normally be no state aid in the meaning of Article 92(1) EC. Conversely, when the public intervention will lead to an overcompensation, the Commission will have to determine whether the aid involved can be approved under one of the derogations of Article 92(2)and(3).

⁷ As mentioned at 2.1 above, the Commission has proposed a modification to the current Voice Telephony Directive. When adopted, this will develop further the precise scope of the universal service concept within the European Community, in particular, with regard to the obligation of affordability.

Examples of such direct support could include providing support from the social security budget to particular operators, or directly to certain customers, to cover the cost of special equipment or tariff packages for users with disabilities.

3. THE ASSESSMENT CRITERIA TO BE USED IN REVIEWING NATIONAL SCHEMES

The list below identifies the assessment the Commission will use when examining national legislation implementing national schemes for universal service.

In Section 5 below more detailed guidelines are provided for National Regulatory Authorities in the Member States in relation to the operation of National Schemes. These guidelines aim to develop best practice within the sector and draw on the principles set out below.

Member States must ensure that National Schemes comply with Community law.

In assessing the conformity with Community law of National Schemes notified to it, the Commission will examine the following points :

THE COSTS THAT CAN BE RECOVERED VIA A NATIONAL SCHEME

The Commission will examine the national approach to calculating the cost of universal service and, in particular, will consider the following points :

1. National Schemes may only cover the “net cost” of universal service obligations as defined in Community law (i.e. the costs associated with the provision of the public fixed telephone networks and publicly available fixed telephone service⁸). The calculation should take account of both costs and revenues. The costing approach should be forward looking, rather than based on historical cost accounting principles.

For an explanation of what is meant by “net cost” and the methodology which is suitable in calculating the net cost of universal service obligations see the guidelines in Section 5 below.

2. National Schemes must ensure that the net cost of universal service is calculated according to objective, transparent, non-discriminatory and proportional criteria and procedures.
3. In order to meet the requirement for transparency and proportionality in the Full Competition Directive, National Schemes must ensure that an operator claiming universal service financing clearly identify (for example by way of a formal declaration), which customers or groups of customers it formally refuses to serve or it intends to disconnect, unless the burden associated with offering service to them is shared via a National Scheme. This does not require an operator to identify those customers individually. Nevertheless, it should be able to indicate the number of customers involved in relation to particular groups or particular areas.

⁸ See Annex I Part I of the Interconnection Directive.

COSTS THAT MAY NOT BE RECOVERED VIA A NATIONAL SCHEME

The Commission will examine National Schemes to ensure that they do not seek to recover net costs which are not attributable to universal service obligations, and, in particular, it will seek to ensure that the following are not included in any cost calculation for universal service.

4. National Schemes may not be used to recover an 'access deficit contribution' attributable to unbalanced national tariff structures⁹. *The issue of such contributions is addressed in Annex B.*

In order to assess the compatibility of National Schemes with Community law, schemes notified to the Commission must include a timetable for the future phasing out of remaining tariff imbalances. Such rebalancing should be completed, at the latest, by 1 January 2000, except in the case of those Member States who have been granted an additional implementation period pursuant to Article 1(2) of the Full Competition Directive. In such cases the date for the completion of such rebalancing shall be the date upon which that additional implementation period ends.

5. Furthermore, on the basis of the Full Competition Directive it would be disproportionate for National Schemes to be used to recover costs associated with activities which are not within the scope of universal service, for example:
 - the cost of implementing specific measures required for purposes of public security;
 - the provision of communication services outside the scope of universal service to schools, hospitals or similar institutions;
 - compensation and/or refund payments (or administrative and other costs associated with such payments) made to users as a result of failure to meet specified service quality levels;
 - the cost of replacement and/or upgrading of telecommunications equipment in the course of normal network modernisation;
6. No account may be taken in calculating the net cost of universal service obligations of the cost of itemised billing, and other facilities (e.g. selective call barring and calling-line identification) where such facilities are imposed as obligations to all voice telephony operators.

⁹ Where it is not possible to complete the rebalancing of tariffs by 1 January 1998, Member States may, in line with the Full Competition Directive (see Recital 20), establish mechanisms separate from National Schemes for universal service to prevent inefficient bypass and "cream skimming" of the incumbent operators, which would be incurred as a result of regulatory controls preventing them from rebalancing their pricing structure (i.e. competing operators (new entrants), are able to undercut the incumbent's tariffs in the international and long-distance market sectors without the incumbent operator being able to respond. These sectors are attractive to competitor's because the incumbent, acting on the basis of commercial principles, must maintain artificially higher prices in those sectors in order to cross-subsidise its regulated below cost charges for access and local calls).

THE MECHANISM CHOSEN TO SHARE THE NET COST OF UNIVERSAL SERVICE OBLIGATIONS AMONGST MARKET PLAYERS

The Commission will examine whether any specific mechanism created to fund universal service operates in an objective, non-discriminatory, transparent and proportionate manner, and, in particular:

7. Where a specific mechanism is considered necessary to share the net cost of universal service obligations amongst market players, National Schemes may collect and distribute contributions either via (i) a universal service fund, established at a national level or (ii) via a system of supplementary charges paid by undertakings interconnecting with the universal service provider.

THE ORGANISATIONS THAT ARE REQUIRED TO CONTRIBUTE TO THE COST OF UNIVERSAL SERVICE

The Commission will examine the scope of organisations which are required to contribute to the costs associated with universal service obligations, and, in particular:

8. National Schemes must identify those organisations who are required to contribute to the net cost of universal service. Contributions may be required from providers of public telecommunications networks and/or publicly available voice telephony services, but only in accordance with the principles of non-discrimination and proportionality and in line with the Commission's Statement to the Minutes of the Council of Telecommunications Ministers on 27 March 1996¹⁰. This means that contributions may be imposed only on voice telephony providers in proportion to their usage of public telecommunications networks.

In the framework of its assessment of the licensing or declaration procedure as regards voice telephony and the provision of public telecommunications networks which the Member States must no later than 1 January 1997 notify under Directive 96/19/EC, the Commission will, in the case of an application/extension of obligations to new entrants and/or mobile operators, assess in particular if the burden is allocated according to objective and non-discriminatory criteria and in accordance with the principle of proportionality. The Member States concerned must therefore sufficiently detail the possible justifications for such application/extension in order to allow the Commission to make its assessment, inter alia as regards the degree of substitutability between mobile telephony and fixed voice telephony service.

The Commission will take a position on these financing schemes in the framework of the formal decisions it will adopt regarding the compatibility of the national declaration or licensing schemes notified by the Member States."

¹⁰ Commission Statement to the Minutes of the 1910th meeting of Council (Telecommunications), 27 March 1996. A Copy of this Minute Statement is set out in Annex C below.

THE BASIS FOR CALCULATING CONTRIBUTIONS TO THE COST OF UNIVERSAL SERVICE

The Commission will examine the method chosen to identify and apportion the contributions to the net cost of universal service amongst market players, and, in particular:

9. National Schemes should apportion contributions amongst eligible market players according to their activity in the relevant market. In order to achieve this National Schemes must provide procedures for identifying clearly the market upon which such activity is measured and determine in a transparent manner the basis for contribution for each eligible organisation to contribute.

WHO MAY BENEFIT FROM PAYMENTS VIA THE NATIONAL SCHEME

The Commission will examine the mechanisms for payments out of National Schemes, and, in particular:

10. Payments via National Schemes must be made in a proportionate, non-discriminatory and transparent manner to organisations subject to universal service obligations.

4. ISSUES TO BE DETERMINED AT A NATIONAL LEVEL

The assessment of National Schemes will also necessarily take into account the overall approach in a Member State to universal service. Member States must therefore assess a range of issues which, in line with the principle of subsidiarity, are mainly a matter of determination at a national level.

These issues include :

- Whether or not obligations relating to universal service are specifically imposed on market players, or whether market forces are relied upon to guarantee the universal availability of an affordable service.
- Whether or not specific pricing constraints (such as requirements for affordability; cost-orientation; uniform national pricing) are imposed as part of any obligation. In this context the Communication on Universal Service of 13 March 1996 it was recognised that “*affordability is at the heart of the framework for universal service in the Community*”. That Communication also indicated that “*Member States should ensure that appropriate measures are taken, (e.g. price caps, targeted tariff schemes) necessary to maintain the affordability of services for all users, particularly in the run up to full competition*”.
- Whether obligations are imposed on one or more market player and how such obligations are imposed (e.g. licensing / primarily legislation / time period).
- Whether Member States seek to franchise universal service obligations or to operate a pay or play system.

Indications of the Commission's approach to these national level issues is provided in Annex D.

5. GUIDELINES FOR THE OPERATION OF NATIONAL SCHEMES

On the basis of the principals set out in the legal framework identified above, this Section now provides detailed Guidelines for the operation of such National Schemes with a view to developing best practice amongst National Regulatory Authorities.

Nationals Schemes should therefore operate in a way which meets the criteria and conditions set out below. These criteria assess three principal aspects for National Schemes:

- I. the calculation of the net cost of universal service
- II the mechanisms for financing universal service obligations, and
- III the determination of who contributes and how costs are shared between contributors.

GUIDELINES FOR NATIONAL REGULATORY AUTHORITIES

I. THE CALCULATION OF THE COST OF UNIVERSAL SERVICE

1. **National Schemes may only relate to costs attributable to the provision of universal service (i.e. costs attributable to the provision of public fixed telephone networks and publicly available fixed telephone services, as set out in Annex I Part 1 of the Interconnection Directive).**

The cost of universal service covers the unavoidable net losses incurred by an efficient operator in providing universal service to customers or groups of customers.

These are customers or groups of customers for whom the benefits to the operator of providing them with service are outweighed by the costs incurred.

Therefore, these are the customers that an operator, acting solely on commercial principles, would choose to disconnect if there was no universal service obligation requiring him to provide service at an affordable price. In areas where the network has not yet been completed, these would be customers to whom the operator would not offer service. These "net cost" customers may be termed "non-viable".

The cost of universal service also covers the provision of public pay phones, of emergency call centres supporting emergency telephone numbers and the provision of certain special equipment of services, for example, to users with disabilities.

2. **Any calculation of the cost of universal service obligations must establish the net cost of such obligations.**

In line with the Full Competition Directive only the net cost of universal service obligations may be recovered via National Schemes.

In line with Annex III of the Interconnection Directive National Schemes must comply with the following principles :

- 2.1 **The net cost calculation must be based on objective, transparent, non-discriminatory and proportionate procedures and criteria.**

2.2 The net cost calculation should :

- (i) **identify the cost, less revenues and associated benefits of providing universal service obligations to a customer or group of customers;**

In the case of existing customers, the cost of providing service should only include the incremental costs less associated revenues, i.e. the net cost that the operator can avoid by withdrawing service (i.e. disconnecting) from "non-viable" customers¹¹.

In the case of new customers, (whether in an area where the network has already been built or in an area where service has yet to be extended), the same approach in principle should be adopted.¹²

In all cases a reasonable¹³ return on the incremental capital employed in providing service to non-viable customers should be allowed.

The assessment of incremental revenues and associated benefits should include:

- connection (i.e. a one off revenue for instalment), rental and call revenues paid by customers or groups of customers (i.e. **direct revenues**).
- the call revenues paid by all commercially viable customers, when calling "non-viable" customers (i.e. **indirect revenues**, including revenues from freephone services and shared cost services).
- the **replacement call revenue**, which should be estimated and set against the incremental direct revenues that would be lost if service were withdrawn from non-viable customers.¹⁴

- (ii) **When calculating net cost a quantification of the intangible benefits of being a universal service provider should be added on the benefit side.**

A valuation should be placed on the intangible benefits of being the provider of universal service obligations for the operator concerned. Although all the benefits of being a universal service provider may not be precisely quantifiable, it should be possible to establish benchmark estimates for the categories identified below, given that such estimates are not uncommon in business valuations. Any such valuation must, however, clearly identify the basis for calculation and any assumptions made. These benefits include the following:

- *Enhanced brand recognition (vis-à-vis competitors).*

¹¹ A long run approach to identifying avoidable costs is the approach most consistent with the principle of non-discrimination.

¹² Calculations of the expected revenue of new customers must be based typical revenue information from existing customers in similar areas.

¹³ A "reasonable rate of return on capital employed (ROCE)" is the minimum rate required to continue attracting necessary funds from investors. As an approximation, ROCE for incumbent operators, based on historic costs, tend to fall in the range of 13 to 19 percent, and when based on current costs, between 6 and 9 percent.

¹⁴ In calculating the revenue lost an estimate should be made of the revenue that a disconnected customer would still generate for the operator through "replacement" calls, i.e. through the use of the telephone of a relative, a friend, at work or public payphones.

- *Universal coverage in the area of ubiquitous operation (i.e. comparatively lower costs than competitors in extending network to new customers).*
- *Life cycle value of particular customers or groups of customers (Life cycle value refers to the fact that a customer who is uneconomic today may become profitable in the future e.g. a "non-viable" young family may become profitable to serve over time as family income begins to rise and the children start using the phone). This means that there is a certain value for an operator in providing service to that customer in the short-term given the revenues generated over the customer's lifetime.*
- *Marketing benefit of accessing full range of telephone usage data.*

(iii) identify separately the net cost of public payphones, emergency services and the provision of special equipment or services (e.g. to disabled users).

The services identified here are different to the provision of the basic telephone service and therefore should be identified separately in any cost calculation by Member States. They are specific services that the operator is required to provide at tariffs that do not provide, in total, sufficient direct or associated benefits to cover the total incremental cost of provision. These services are sometimes termed "uneconomic services". They are the services that would not be provided according to normal commercial principles if they were not mandated by regulation.

In the case of emergency services, a distinction must be made between the obligation to provide free emergency calls, which is generally placed on all operators (so that each bears its own costs) and the obligation on one operator to provide an emergency call centre, with trained staff, to handle emergency calls at a national or regional level. The net cost of such a call centre would be recoverable via a National Scheme for universal service.

Public payphones may also impose a loss on the operator, and where this is the result of a regulated averaged call price, the total net incremental cost to the operators of providing payphones (i.e. incremental costs less all associated revenues) may be added to the cost of universal service.

Where such services are provided at prices, which result in the total incremental revenues (if any) not covering the total long-run incremental cost of service provision, the net cost incurred should be added to the cost of universal service.

2.3 National Schemes should calculate costs under 2.1 and 2.2 on the basis of investments and operating costs that could be avoided if the operator stopped providing service to 'non viable' customers or groups of customers. "Non viable" refers to customers where the total direct and indirect revenue for the operator (calculated as set out at 2.2 above) is less than the cost of providing service to that customer.

The "avoidable cost" principle followed in these cost calculations applies both to operating costs and fixed costs associated with capital equipment. Where there are sunk investments (i.e. investments which once made cannot be fully recovered) that could have been avoided but for the universal service obligation, an appropriate rate of return on capital employed should be included as an element in the incremental cost calculations.

The value taken for any fixed investments should not be the one appearing in the operator's accounts, but the current cost of a capital investment required to provide a similar service today¹⁵.

- 2.4** The actual process of quantifying universal service costs in any Member State is likely to require an assessment of likely net cost areas, which may be explained by a number of factors, such as, the social/economic make up of subscribers, the density of subscribers and the topography of the landscape.

The methodology proposed under 2.2 and 2.3 above, will also account for the net cost of serving "non-viable" customers in so called high cost areas. No additional calculation for high cost areas is permitted, where this results in double counting of the cost of serving "non-viable" customers.

- 2.5** National Schemes should only relate to the financing of the net cost of universal service obligations in respect of which the operator, subject to that universal service obligation, has explicitly declared that he is only able to provide the service at a net cost to himself.

Such a declaration should be made to the National Regulatory Authority and should identify those customers or groups of customer or those services which the operator concerned would not serve, but for universal service obligations, or in the case of provision to new customers or in new areas, will not be prepared to serve on request.

- 3.** In line with the Full Competition Directive, National Schemes for calculating the cost of universal service obligations may not include an 'access deficit contribution' attributable to unbalanced national tariff structures.

Traditionally, operators have often ensured cheap connection, rentals (and sometimes local calls) by cross-subsidies from long distance and international call revenues. This has often meant that the connection charge and the access line rental does not result in a reasonable rate of return on the capital employed by those operators in providing that access.

Where an operator, which does not face competition, has an "access deficit", the operator is typically compensated by very high profits generated by other services such as international and long distance calls. Where this situation exists, the operator's tariffs are "out of balance" with the costs it incurs¹⁶. In a competitive marketplace an operator should not be forced to maintain such tariff imbalances.

- 4.** National Schemes notified to the Commission must include a timetable for the future phasing out of remaining tariff imbalances. Such rebalancing should be completed, at the latest, by 1 January 2000, except in the case of those Member States who have been granted an additional implementation period pursuant to Article 1(2) of the Full Competition Directive. In such cases the date for the

¹⁵ The governing principle is that competitors should only be required to pay for universal service provision according to the minimum cost of an efficient operator providing that service to-day. At the same time, account should be taken in identifying those costs of any regulatory restrictions which would prevent the universal service provider from using the most efficient technology (for example, restrictions placed on incumbent network operators from using wireless solutions in rural or remote areas).

¹⁶ Unbalanced tariffs, or its corollary, an access deficit, do not equate to a genuine 'net loss' for the operator as the operator is usually compensated by the large profits from other activities, such as long distance and international calls. Indeed, it is likely that most customers receiving subsidised access will still be profitable for the operator to serve, based on the incremental revenues that are attributable to them. Those customers who impose a net cost on the operator will be captured in the net cost exercise described in section 2.2 above.

completion of such rebalancing shall be the date upon which that additional implementation period ends.

5. Where it has not be possible to complete the rebalancing of tariffs by 1 January 1998, Member States may, in line with the Full Competition Directive¹⁷, establish mechanisms separate from National Schemes for universal service to prevent new entrants from unfairly taking advantage of the structure of prices (i.e. high charges for international and long-distance services which are not oriented towards cost) created by the regulation of the incumbent operator's prices.

Such mechanisms must be based on objective, transparent, non-discriminatory and proportionate procedures and criteria.

The principles for such access deficit schemes are discussed further in Annex B.

6. No account may be taken in calculating the net cost of universal service obligations which are outside the scope of universal service, for example:
- 6.1 the cost of implementing specific measures required for purposes of public security;
 - 6.2 the provision of communication services outside the scope of universal service to schools, hospitals or libraries;
 - 6.3 compensation and/or refund payments (or administrative and other costs associated with such payments) made to users as a result of failure to meet specified service quality levels;
 - 6.4 the cost of replacement and/or upgrading of telecommunications equipment in the course of normal network modernisation;
7. No account may be taken in calculating the net cost of universal service obligations of the cost of itemised billing, and other facilities (e.g. selective call barring and calling-line identification) where such facilities are imposed as obligations to all voice telephony operators.

II THE MECHANISM FOR FINANCING UNIVERSAL SERVICE OBLIGATIONS

8. Mechanisms for financing universal service obligations within National Schemes must be based on objective, transparent, non-discriminatory and proportionate criteria and procedures. This includes situations where a specific financing mechanism is not set up or where the State funds directly or indirectly the cost of some or all elements of universal service.
9. In line with the Full Competition and Interconnection Directives, National Schemes may provide a mechanism for sharing any unfair burden resulting from the net costs associated with the provision of universal service obligations amongst other market players.
10. Such mechanisms within National Schemes may take the form of either a universal service fund established at a national level or a system of supplementary charges.

¹⁷ See in particular Recital 20 of the Full Competition Directive.

The rules for calculation of the net cost of universal service, set out above, are the same for both financing mechanisms. Only the collection of universal service contributions from the relevant market players is different under the two schemes.

11. National Schemes may combine elements of both mechanisms in order to ensure that any unfair burden associated with the net costs of universal service obligations are shared fairly amongst market players, providing that there is no undue discrimination, and that no organisation is required directly or indirectly to contribute more than once in respect of the net cost of a particular universal service obligation.

12. Universal Service Funds

12.1 Where National Schemes incorporate a Universal Service Fund, the body administering that fund should meet the following criteria:

- a) **The fund shall be administered by a body independent of the contributing and recipient undertaking(s).**
- b) **That body shall be responsible for collecting contributions from operators and service providers who are liable to contribute to the cost of universal service obligations in that Member State and will oversee the transfer of sums due and/or administrate out-payments to the persons and/or organisations entitled to receive payments from the Fund.**

In administering the financial arrangements for universal service, National Schemes should seek to minimise the administrative burden imposed and the resulting costs. For that reason, the body administering a Fund may act as an "auditor" and "clearing house" for payments or may simply oversee payments directly between the organisations concerned.

- c) **The responsibility for verifying the net cost of universal service obligations should remain with the relevant National Regulatory Authority.**

12.2 Out payments from the fund to the organisations incurring a net cost attributable to universal service obligations must be made according to proportionate, non-discriminatory and transparent criteria.

13. A system of supplementary charges

13.1 National Schemes providing for a system of supplementary charges must ensure that the operator(s) concerned determine(s) the net cost of universal service obligation, as well as the specific contributions to be collected via the system of supplementary charges in an transparent, non-discriminatory and proportionate manner and subject to review by the National Regulatory Authority.

National Schemes should ensure, in particular, that there is no conflict of interest between an operator's commercial activities and its role in collecting in-payments from its competitors.

Any contribution to be paid via a system of supplementary charges should be calculated annually and based on an annual calculation of the cost of universal service obligations.¹⁸

13.2 The sum due should be collected within a reasonable time period from the organisations concerned. The payment may be collected as a one off payment

¹⁸ See Article 5(5) of Interconnection Directive.

on an annual basis or at any other frequency determined by the relevant National Regulatory Authority.

13.3 National Schemes must ensure the transparency of any system of supplementary charges.

This requires the unbundling of traffic charges for interconnection from any identified contribution to the cost of universal service. In addition, the universal service provider should itself indicate separately the extent of its own contributions toward the cost of universal service.

III DETERMINATION OF WHO CONTRIBUTES AND THE CALCULATION OF THE LEVEL OF CONTRIBUTIONS WITHIN NATIONAL SCHEMES

14 In line with the Full Competition Directive and the Interconnection Directive, only organisations providing public telecommunications networks and/or public voice telephony services may be required under National Schemes to contribute to a Universal Service Fund or to any system of supplementary charges. Any requirement for contribution must however be in accordance with the principles of non-discrimination and proportionality and in line with the Commission's Statement on this issue at the Council of Telecommunications Ministers in March 1996 (See Annex D). This means that contributions may only be imposed on voice telephony providers in proportion to their usage of public telecommunications networks.

In the framework of its assessment of the licensing or declaration procedure as regards voice telephony and the provision of public telecommunications networks which the Member States must no later than 1 January 1997 notify under Directive 96/19/EC, the Commission will, in the case of an application (extension) of obligations to new entrants and/or mobile operators, assess in particular if the burden is allocated according to objective and non-discriminatory criteria and in accordance with the principle of proportionality. The Member States concerned must therefore sufficiently detail the possible justifications for such application/extension in order to allow the Commission to make its assessment, inter alia as regards the degree of substitutability between mobile telephony and fixed voice telephony service.

The Commission will take a position on these financing schemes in the framework of the formal decisions it will adopt regarding the compatibility of the national declaration or licensing schemes notified by the Member States."

15. Examples of organisations which are not liable to contribute to financing universal service include (i) private network operators offering corporate networking or closed user group services), (ii) service providers offering data communications or value-added data services, (such as e-mail), and (iii) service providers offering enhanced voice telephony services¹⁹ such as video-conferencing, voice mail services, and voice enquiry/reply services such as home-banking or tele-shopping,

The scope of the contribution base for universal service may evolve over time in line with changes in technology and market structure.

¹⁹ With regard to the provision of voice telephony service via the Internet, this is not currently viewed as a publicly available voice telephony service. (see Commission Notice [...] regarding the status of voice on the Voice on the Internet under Directive 90/388/EEC). Contributions cannot therefore be required today from Internet Access Providers, though organisations providing Internet access via their own network would normally have contributed on the basis of their operation of a public network.

16. National Schemes should apportion contributions amongst eligible market players according to their activity in the relevant market. In order to achieve this National Schemes should provide procedures for identifying clearly the market upon which such activity is measured and determine in a transparent manner the basis for contribution for each eligible organisation to contribute.
17. National Schemes must ensure that the level of contribution required from the eligible organisations identified at 14 above is calculated in an objective, transparent, non-discriminatory and proportionate manner. In order to ensure this, National Schemes should comply with the following principles:
 - 17.1. In line with the principle of subsidiarity, Member States may determine the specific criteria within National Schemes for apportioning contributions amongst eligible market players, providing such criteria meet the requirements of paragraph 16 above.
 - 17.2 National Schemes should ensure that the apportionment of contributions does not unduly distort investment incentives and economic efficiency.
 - 17.3 National Schemes should ensure that the criteria chosen to determine market share of eligible organisations does not have a disproportionate or discriminatory effect on particular players.

A number of indicators, such as revenues before tax; call minutes, number of subscribers and overall profit, might be used to measure the activity of eligible organisations. Nevertheless, whatever method is chosen should operate in a proportionate, non-discriminatory and transparent manner, and should encourage competition whilst avoiding unjustified administrative or accounting burdens of the players concerned. For example, Member States should avoid criteria which unduly distort patterns of market entry, activity or investment by market players.

- 17.4 National Schemes should ensure that the collection mechanism prevents "double contributions".

One example of a double contribution would be where a service provider, providing service via leased lines is required to contribute directly to a universal service fund according to his activity level (e.g. gross revenues), even though the tariff for the leased lines has been set by the network operator to recover that operators contribution to universal service as a provider of a public telecommunications network. In such a situation the direct and indirect contribution would incur duplicate payment of that Service Provider towards the cost of universal service obligations.

6. CONCLUSION

This Communication has identified the criteria which the Commission will use in assessing the costing and financing aspects of National Schemes for universal service which must notified to the Commission in line with the deadlines established in the Full Competition Directive.

The Commission intends to review such notified schemes in the first half of 1997 in order to allow Member States to take any necessary steps to adapt such schemes to the requirements of Community law in good time to permit the full liberalisation of the telecommunications market by 1 January 1998.

In the light of its experience in assessing the schemes notified to it, and of the results of an important study of the practical aspects of costing and funding universal service in a competitive environment, the Commission intends to draw conclusions in the form of practical guidelines for the telecommunications industry, for regulators and for users, to develop best practice with the Community.

This Communication is now submitted to the Member States to assist them as they finalise their National Schemes.

ANNEX A : RELEVANT PROVISIONS OF COMMUNITY LAW RELATING TO UNIVERSAL SERVICE

Article 4C of Full Competition Directive²⁰

Without prejudice to the harmonization by the European Parliament and the Council in the framework of ONP, any national scheme which is necessary to share the net cost of the provision of universal service obligations entrusted to the telecommunications organizations, with other organizations whether it consists of a system of supplementary charges or a universal service fund, shall,

- (a) apply only to undertakings providing public telecommunications networks;
- (b) allocate the respective burden to each undertaking according to objective and non-discriminatory criteria and in accordance with the principle of proportionality.

Member States shall communicate any such scheme to the Commission so that it can verify the scheme's compatibility with the Treaty.

Member States shall allow their telecommunications organizations to re-balance tariffs taking account of specific market conditions and of the need to ensure the affordability of a universal service, and, in particular, Member States shall allow them to adapt current rates which are not in line with costs and which increase the burden of universal service provision, in order to achieve tariffs based on real costs. Where such rebalancing cannot be completed before 1 January 1998 the Member States concerned shall report to the Commission on the future phasing out of the remaining tariff imbalances. This shall include a detailed time-table for implementation.

In any case, within three months after the European Parliament and the Council adopt a directive harmonizing interconnection conditions, the Commission will assess whether further initiatives are necessary to ensure the consistency of both directives and take the appropriate measures.

In addition, the Commission shall, no later than 1 January 2003, review the situation in the Member States and assess in particular whether the financing schemes in place do not limit access to the relevant markets. In this case, the Commission will examine whether there are other methods and make any appropriate proposals.

²⁰ Commission Directive 96/19/EC of 13 March 1996 amending Commission Directive 90/388/EEC regarding the implementation of full competition in telecommunications markets ("the Full Competition Directive").

Article 2 (g) of Interconnection Directive²¹

- (g) "universal service" means a defined minimum set of services of specified quality which is available to all users independent of their geographical location and, in the light of specific national conditions, at an affordable price.

Article 5 of Interconnect Directive²¹

Interconnection and universal service contributions

1. Where a Member State determines, in accordance with the provisions of this Article, that universal service obligations represent a unfair burden on an organization, it may establish mechanisms for sharing the net cost of the universal service obligations with other organizations operating public telecommunications networks and/or publicly available voice telephony services. Member States shall take due account of the principles of transparency, non-discrimination and proportionality in setting the contributions to be made. Only public telecommunications networks and publicly available telecommunications services as set out in Part 1 of Annex I may be financed in this way.
2. Contributions to the cost of universal service obligations if any may be based on a mechanism specifically established for the purpose and administered by a body independent of the beneficiaries, and/or may take the form of a supplementary charge added to the interconnection charge.
3. In order to determine the burden if any which the provision of universal service represents, organizations with universal service obligations shall, at the request of their national regulatory authority, calculate the net cost of such obligations in accordance with Annex III. The calculation of the net cost of universal service obligations shall be audited by the national regulatory authority or another competent body, independent of the telecommunications organization, and approved by the national regulatory authority. The results of the cost calculation and the conclusions of the audit shall be open to the public in accordance with Article 14(2).
4. Where justified on the basis of the net cost calculation referred to in paragraph 3, and taking into account the market benefit if any which accrues to an organization that offers universal service, national regulatory authorities shall determine whether a mechanism for sharing the net cost of universal service obligations is justified.
5. Where the mechanisms referred to in paragraph 4 are established, national regulatory authorities shall ensure that the principles for cost sharing, and details of the mechanism used, are open to the public in accordance with Article 14(2).

²¹ COMMON POSITION (EC) No 34/96 adopted by the Council on 18 June 1996 with a view to adopting Directive 96/.../EC of the European Parliament and of the Council of ... on interconnection in telecommunications with regard to ensuring universal service and interoperability through application of the principles of open network provision (ONP).

National regulatory authorities shall ensure that an annual report is published giving the calculated cost of universal service obligations, and identifying the contributions made by all the parties involved.

6. Until such time as the procedure described in paragraphs 3, 4 and 5 is implemented, any charges payable by an interconnected party which include or serve as a contribution to the cost of universal service obligations shall be notified, prior to their introduction, to the national regulatory authority. Where the national regulatory authority finds on its own initiative, or after a substantiated request by an interested party, that such charges are excessive, the organization concerned shall be required to reduce the relevant charges. Such reductions shall be applied retrospectively, from the date of introduction of the charges, but not before 1 January 1998.

Annex I, part 1 of Interconnect Directive²¹

The fixed public telephone network

The fixed public telephone network means the public switched telecommunications network which supports the transfer between network termination points at fixed locations of speech and 3,1 kHz bandwidth audio information, to support inter alia:

- voice telephony;
- facsimile Group III communications, in accordance with ITU-T Recommendations in the "T-series";
- voice band data transmission via modems at a rate of at least 2 400 bit/s, in accordance with ITU-T Recommendations in the "V-series".

Access to the end-user's network termination point is via a number or numbers in the national numbering plan.

The fixed public telephone service according to Directive 95/62/EC of the European Parliament and of the Council of 13 December 1995 on the application of open network provision (ONP) to voice telephony⁽²²⁾

The fixed public telephone service means the provision to end-users at fixed locations of a service for the originating and receiving of national and international calls, and may include access to emergency (112) services, the provision of operator assistance, directory services, provision of public pay phones, provision of service under special terms and/or provision of special facilities for customers with disabilities or with special social needs.

Access to the end-user is via a number or numbers in the national numbering plan.

²² OJ No L. 321, 30.12.1995, p.6.

CALCULATING THE COST OF UNIVERSAL SERVICE OBLIGATIONS FOR
VOICE TELEPHONY

Referred to in Article 5(3)

Universal service obligations refer to those obligations placed upon an organization by a Member State which concern the provision of a network and service throughout a specified geographical area, including – where required – averaged prices in that geographical area for the provision of that service.

The cost of universal service obligations shall be calculated as the difference between the net cost for an organization of operating with the universal service obligations and operating without the universal service obligations.

This applies whether the network in a particular Member State is fully developed or is still undergoing development and expansion.

The calculation shall be based upon the costs attributable to:

- (i) elements of the identified services which can only be provided at a loss or provided under cost conditions falling outside normal commercial standards.

This category may include service elements such as access to emergency telephone services, provision of certain public pay telephones, provision of certain services or equipment for disabled people, etc.

- (ii) specific end-users or groups of end-users who, taking into account the cost of providing the specified network and service, the revenue generated and any geographical averaging of prices imposed by the Member State, can only be served at a loss or under cost conditions falling outside normal commercial standards.

This category includes those end-users or groups of end-users which would not be served by a commercial operator which did not have an obligation to provide universal service.

In peripheral regions with expanding networks, the cost calculation should be based on the additional cost of serving those end-users or groups of end-users which an operator applying the normal commercial principles of a competitive environment would choose not to serve.

Revenues shall be taken into account in calculating the net costs. Costs and revenues should be forward-looking.

ANNEX B: ACCESS DEFICIT CONTRIBUTION SCHEMES.

Assessment Criteria to Access Deficit Schemes

As indicated in the Assessment Criteria for National Schemes above, Member States may establish separate mechanisms which address the effects resulting for an incumbent operator of regulatory constraints on its tariff structure, i.e. controls on the speed with which it can rebalance its tariffs in order to meet the requirement for rebalancing in the Full Competition Directive.

Such schemes should be separate from the National Scheme for costing and financing the net cost of universal service obligations in a Member State.

Such schemes should be based on objective, transparent, non-discriminatory and proportionate procedures and criteria and should only be created on a temporary basis.

In order to meet these conditions such schemes should comply with the principles set out below:

1. After 1 January 1998, the operators concerned retain significant cross-subsidies for residential access going beyond what would be expected according to normal commercial practices, (i.e. such operators are subject to regulatory constraints which have prevented them from completing the process of tariff rebalancing and this has resulted in tariff structures which are substantially out of line with the capital invested in providing local access).
2. Access Deficit Schemes should be implemented only on a temporary basis and only until 1 January 2000.

In principle, access deficit schemes take the retail price structure (or the profitability of the various business areas) of the incumbent as the starting point for calculating the interconnection price, and allow a discount on these prices to give the price for interconnect for a particular type of call or service. The calculation is therefore top down, rather than a bottom up approach based on the actual costs incurred.

As a result any access deficit scheme will prevent effective competition from becoming established as competitors (entrants) will be forced to charge higher prices for those services, which contribute to the incumbent's access deficit. This type of interconnection pricing regime undermines the incentives for the incumbent to orient its prices towards cost. These effects distort investments within the industry and can only be considered as a temporary exception to the Treaty competition rules.

3. Any Access Deficit Scheme should require the clear identification of any "deficit" claimed, calculated in a proportionate, non-discriminatory and transparent manner. The calculation should be subject to independent verification. The calculation should identify the allocation of the capital employed to provide access, together with any common

and joint costs which should be allocated according to the principles of proportionality and non-discrimination.

4. Safeguards to ensure the transparency of any Access Deficit Scheme are of particular importance, given the considerable discretion available to an incumbent operator with regard to the allocation of common / joint costs within its business. Access Deficit Schemes should not be used in a way which simply finances inefficiencies within an incumbent operator's activities.
5. Information concerning the implementation of such schemes, as well as the timetable for their phasing out should be notified to the Commission alongside the notification of National Schemes for universal service (i.e. by 11 January 1997²³ 1996).

In the absence of such information it will not be possible for the Commission to assess the compatibility of National Schemes with the EC Treaty.

6. Any Access Deficit Scheme should be structurally separate from any National Scheme for Universal Service.

The purpose of an access deficit scheme is to address the effects, of inefficient bypass and cream skimming, created by regulatory constraints on the incumbent's tariff structure. The "deficit" does not represent a genuine loss for the operator concerned. It is not therefore part of the net cost of providing elements of universal service.

7. National Regulatory Authorities should ensure that other market players only contribute to any access deficit where the competitor uses some part of the network (i.e. interconnects) of the incumbent to transmit a call.

If the competitor is able to offer to customers an end to end service which does not use or interconnect to the incumbent's network, no access deficit contribution should be payable.

8. Access deficit contributions should be calculated on the basis of the contribution to the access deficit that the incumbent loses when the revenue (tariff) that would have gone to the incumbent, is instead paid to a competitor, even though the call was transported partly via the incumbent's network²³. The access deficit contribution will be less than the full contribution to the access deficit that the incumbent would have earned had it transported the entire call, because of the effects of competition in expanding the market. A portion of the interconnected traffic should be considered new traffic for which there can be no contribution foregone by the *incumbent*.

²³ Where no interconnection takes place, no contribution to the access deficit should be made.

**ANNEX C : COMMISSION STATEMENT TO THE MINUTES OF THE
1910TH MEETING OF COUNCIL (TELECOMMUNICATIONS)
ON 27TH MARCH 1996 ON WHO CONTRIBUTES TO
UNIVERSAL SERVICE**

"In relation to Article 5(1) of the common position on the proposal for a Directive on interconnection in telecommunications, the Commission recalls that Article 4c of Commission Directive 96/19/EC of 13 March 1996 amending Directive 90/388/EEC regarding the implementation of full competition in telecommunications markets states that, where Member States set up mechanisms for sharing the net cost of universal service obligations, they should apply these mechanisms to undertakings providing public telecommunications networks. The Directive further states that the respective burden must be allocated according to objective and non discriminatory criteria and in accordance with the principle of proportionality. According to the latter principle contributions should, as emphasised in recital 19 of the Commission Directive, seek only to ensure that market participants contribute to the financing of universal service. The Commission notes that Parliament and Council Directive 95/62/EC on the application of ONP to voice telephony defines the scope of universal service obligations, which burden may be financed through universal service mechanisms. Furthermore, the principle of non discrimination opposes financing mechanisms for the universal service obligations which lead either to double contributions to the cost of universal service in the same Member State or to all undertakings in the telecommunications markets subsidising the voice telephony operators. Consequently contributions should be limited to services within the scope of the universal service definition.

The Commission will therefore interpret both Article 4c of the Commission Directive and 5(1) of this common position as allowing contributions only to be imposed on voice telephony providers in proportion to their usage of public telecommunications networks."

ANNEX D: ASPECTS OF NATIONAL SCHEMES ADDRESSED MAINLY AT THE NATIONAL LEVEL

Even though the needs of the internal market and aim of ensuring a high standard of consumer protection mean that a common concept of universal service is required at a Community level, many of its aspects are closely linked to the specific situation in each Member State. As a result considerable day to day responsibility is placed on National Regulatory Authorities, for example, to determine what is "affordable" service in a particular Member State.

In line with the principle of subsidiarity, a range of issues will be addressed mainly at a national level concerning the management of the universal service obligations. These approaches create the overall framework within which National Schemes will operate. National approaches in these areas must remain consistent with Community law, and in particular, must be proportional, non-discriminatory, transparent and based on objective criteria and procedures. Whilst such issues are not the primary focus of this Communication, the Commission will necessarily examine the approach chosen in order to assess properly the National Schemes submitted to it.

The need for specific obligations to be imposed to guarantee universal service

- The first issue is **whether there is a need for specific obligations placed on certain operators to provide universal service, or whether voluntary use by operators of special and/or customer targeted tariff schemes is achieving the overall aim of ensuring affordable service.**

The principle of proportionality means that obligations should be imposed in relation to universal service only where there is a risk that the goal of ensuring affordable access to a defined level of universal service throughout a given area cannot be achieved in a competitive environment without the creation of specific mechanisms to share fairly amongst market players any identified costs attributable to those obligations which the universal service provider(s) has (have) incurred.

Pricing decisions as part of universal service obligations

- A second issue is **the decision on pricing policies** (e.g. national choices to apply a uniform national tariff or to allow some degree of tariff deaveraging / determination of affordability / use of mechanisms to control the speed of rebalancing).

Community policy with regard to pricing is confined to specific obligations for cost-orientation of the tariffs for certain services (e.g. Leased lines, Interconnection charges) and an obligation of affordability with regard to the delivery of universal service²⁴. **Community policy does not require nor prevent decisions at a national level, for example, to maintain uniform**

²⁴ See COM(96) 419 of 11 September 1996, Proposal for a European Parliament and Council Directive on the application of open network provision (ONP) to voice telephony and on universal service for telecommunications in a competitive environment (replacing European parliament and Council Directive 95/62/EC).

national prices or to allow deaveraging, providing the overall affordability of the service is not called into question.

At the same time, in the Communication on Universal Service the Commission made clear that *“greater [tariff] flexibility must be conditional upon the regulatory framework (i) including adequate measures to ensure affordability ; ensuring that price increases for users in remote and rural areas, other than adjustments to achieve cost-orientation, are not used to compensate operators for losses in revenue resulting from price decreases elsewhere and (iii) ensuring that any differences in pricing between high cost areas and low cost areas do not endanger the affordability of universal service”*.

The organisation of the universal service obligation at a national level

Once that decision is taken to entrust universal service provision to one or more organisations, National Regulatory Authorities are likely to decide a range of additional issues which impact the operation of National Schemes:

- Whether there will be one or multiple providers with universal service obligations in a Member State or particular areas within a Member State;
- Whether universal obligations will be imposed by geographical areas (e.g. the whole territory or by region) or by service category (e.g. provision of public voice telephony; provision of payphones);
- Procedures for imposing universal service obligations (e.g. imposition through regulatory instruments / use of tendering procedures / time scale for review of obligations);
- Administrative aspects (e.g. structure and management of universal service fund / payment mechanisms for universal service (e.g. out of a fund / direct State funding / user of vouchers to pay subsidies directly to needy customers / valuation of contributions in kind).

Universal Service contributions through 'Pay or Play' schemes

A key issue to be addressed is the basic choice as to who will provide universal service and how that or those provider(s) will be selected. Once again, provided the general principles of objectivity, proportionality, non-discrimination and transparency are observed, this decision is principally an issue of subsidiarity.

At the same time, there should not be an automatic assumption that the current universal service provider must continue to provide universal service or be the only provider, or equally that universal service should be maintained as a single bundled offering. It will remain important within any scheme to ensure that adequate incentives are provided to encourage cost-efficient delivery of universal service. This will limit the possible distortive effects on market entry and investments which higher than necessary universal service costs may have.

One means of achieving this may be to place elements of universal service out to tender on either a geographical basis or for specific service elements, such as the provision of public payphones. This would allow competitors to bid to provide elements of universal service of equal or improved quality, with the tender being

awarded to the organisation offering to provide service of specified quality at the lowest level of subsidy. In the event that no bid to provide service, the NRA would retain a residual power to impose universal service obligations.

Another means would be to invite for tenders among competitors, as above, but on franchising terms (i.e. specified service, quality and end-user prices) awarding the universal service provision obligation to the service provider asking for least subsidy to provide the universal service element in an uneconomic area. This approach may be particularly important in those Member States where the process of network build out has not yet been fully completed to all areas.

Closely linked to this issue of franchising is the relationship between those providing universal service and those contributing to its cost. In general, those providing elements of universal service should be able to offset the net cost of such provision against contributions which they would otherwise be required to make through a financing mechanism. A valuation of that cost should take into account the marketing and commercial benefits which may be seen to accrue from being a universal service provider. This is often termed a "pay or play" approach, though in reality, it is more likely to be "pay and play".

TECHNICAL GLOSSARY

<i>Access Capital</i>	This is the capital employed to provide customer local access to the public telephone network.
<i>Access Deficit</i>	"Access deficit" refers to the case where the revenues an operator earns from connection and rental charges do not provide it with a reasonable rate of return on capital employed in providing access.
<i>Avoidable (decremental) Cost</i>	Similar concept to incremental cost, except that instead of the cost relating to an "outward" increment in output the focus is on the cost that can be 'avoided' by a decrement in output.
<i>Capital Employed</i>	The assets attributed to the provision of a particular service or sector (e.g. local access, international calls, pay-phone service, etc.).
<i>Connection Charge</i>	The one-off price charged to connect a customer to an operator's network.
<i>Franchising</i>	A transfer for a specific period of a right or obligation which have a 'public' purpose. It involves an activity which is performed on a commercial basis.
<i>High Cost Area</i>	refers to an area with less developed voice telephony infrastructure, where the cost of providing customer access to the voice telephony network is significantly higher than in well developed areas.
<i>Incremental Capital Employed</i>	This is the additional capital required by an operator to conduct a particular activity. The activity (or increment in activity) may, for example, relate to a customer or group of customers, or to a specific type of service.
<i>Incremental Cost</i>	is a cost standard which measures the change in total cost arising from a discrete or substantial increase/decrease in output (i.e. serving service).
<i>Incremental Revenue</i>	refers to the total change in revenue as a result of a particular activity (or increment in activity).
<i>Line Rental Charge</i>	A periodic fixed charge based on the type of service and facilities selected by the user.
<i>Long-run Avoidable Cost</i>	refers to the cost that an operator could avoid over the long run if it was to discontinue a particular activity (or increment in activity).
<i>Long-run Incremental Cost</i>	See long-run avoidable cost (above).
<i>Non-viable Customer</i>	A customer is said to be non-viable when the total increment in revenue associated with a customer is less than the incremental cost incurred by the operator in serving that customer.

<i>Not Incremental Cost</i>	The incremental costs less all associated incremental revenues.
<i>Rate of Return on Capital Employed</i>	or " <i>accounting rate of return</i> ", is the ratio of accounting profit to accounting capital employed.
<i>Rebalancing of Tariffs</i>	Process whereby prices for universal service elements are adjusted relative to each other (e.g. when implementing cost related prices).
<i>Sunk Investments</i>	Investments which once made cannot be fully recovered.
<i>Unavoidable Net Losses</i>	The net loss an operator cannot avoid as a result of being obliged to provide uneconomic universal service or provide service to uneconomic customers.
<i>Uneconomic Services</i>	Services for which the incremental cost of provision is greater than all the associated incremental revenues(if any) the operator gets from the service.
<i>User</i>	Users means end-users, including consumers (e.g. residential end-users), and service providers, including telecommunications organisations where the latter provide services which are or maybe provided by others.