

UNIVERSAL SERVICE DESIGNATION

A report on designation mechanisms for universal service providers in different IRG countries and evaluation of the impact of divergences on the internal market

Compiled by IRG members

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1. Introduction

The objective of this paper is to monitor and report on designation mechanisms for universal service providers in different IRG countries and evaluate any impact of divergences on markets.

After describing the European legal framework (2) as provided by the Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (the "USD"), the paper will try to give basic definitions of various principal approaches how a universal service provider ("USP") might be designated; furthermore, those approaches are evaluated under the criteria as set out in Art 8 (2) of the USD (3). Following that, the paper will focus on examples for mechanisms used for designating USPs in several IRG countries and look at their impact on the market (4).

This document intends to provide guidance to Member States/NRAs (as appropriate) in choosing mechanisms for designating USPs according to the criteria set out in the USD.

2. Legal Framework

The designation of USPs is described in the USD. Article 8 of the the USD states:

1. Member States may designate one or more undertakings to guarantee the provision of universal service as identified in Articles 4, 5, 6 and 7 and, where applicable, Article 9 (2) so that the whole of the national territory can be covered. Member States may designate different undertakings or sets of undertakings to provide different elements of universal service and/or to cover different parts of the national territory.
2. When Member States designate undertakings in part or all of the national territory as having universal service obligations, they shall do so using an efficient, objective, transparent and non-discriminatory designation mechanism, whereby no undertaking is a priori excluded from being designated. Such designation methods shall ensure that universal service is provided in a cost-effective manner and may be used as a means of determining the net cost of the universal service obligation in accordance with Article 12.

According to Articles 4, 5, 6 and 7 of the the USD, universal service covers the services listed below:

- connection to the public telephone network at a fixed location and for access to publicly available telephone services at a fixed location
- access to directories and directory inquiry services
- provision of public payphones
- where appropriate, specific measures for disabled users to ensure access to and affordability of publicly available telephone services.

According to Article 9 (2), Member States may require that designated undertakings provide tariff options or packages which depart from those provided under normal commercial conditions to consumers to ensure that those on low incomes or with special social needs are not prevented from accessing or using the public telephone network.

2.1 Principles for designation mechanisms

Art 8 (2) of the USD lists the following criteria which have to be met by USP designation mechanisms:

The mechanism must be efficient, objective, transparent and non-discriminatory, whereby no undertaking is a priori excluded from being designated.

Such designation methods shall ensure that universal service is provided in a cost-effective manner and may be used as a means of determining the net cost of the universal service obligation ("USO") in accordance with Article 12.

The criteria mentioned in the USD are elaborated upon below.

- **Efficient**

This may be interpreted as meaning that the mechanism must offer appropriate methods to assign USOs to an operator(s) who is best able to fulfil those tasks at the least cost for the designation period and at the quality specified in the designation instrument (be it by law/ordinance, tender or other means).

- **Objective**

An objective evaluation of the criteria used for choosing the USP should ensure that– where a choice among several candidates is possible – the candidate best able to meet the obligations is selected. In addition, the integrity of the selection process is paramount given its relationship with how obligations are to be fulfilled and the question of funding a net cost of provision (and unfair burden), if any.

- **Transparent**

A designation mechanism which is transparent for all market participants (competing operators as well as customers) should ensure that perspective USPs can evaluate whether they wish to enter any designation process and, after its completion, provide adequate reasoning behind the decision to award the USO to a particular operator(s). A transparent designation process may contribute to a higher acceptance by operators of any USO funding obligations that may arise (subject to evaluation of net cost/unfair burden).

- **Non-Discriminatory**

It is clear from the USD that only a non-discriminatory designation process is qualified for complying with the criteria set out in Art. 8 (2). Therefore, the designation mechanism must ensure that – based on the rules setting the requirements of assigning USOs to a certain provider(s) – no provider which is entitled to participate in a designation process is excluded by virtue of the chosen designation mechanism (this does not mean that a prospective

operator can not be ruled out by virtue of not meeting criteria necessary for the fulfilment of the USO).

The importance of this criterion is underlined by the explicit reference in the USD to the fact that no undertaking may a priori be excluded from being designated.

3. Principal approaches of designating universal service providers

3.1 General remarks

This section describes two principal approaches for designating a USP: by imposing an obligation or by tender. These two approaches – and variations thereof – are discussed below.

3.2. Designation by obligation

3.2.1. Legal Instrument (Act/ordinance)

A USP may be designated by a legal provision (Act or ordinance). In such cases, this provision will form part of national telecoms legislation. The criteria under which an undertaking is designated lie within the lawmaker's responsibility. They have not been specified up to now in some Member States but would have to be published following implementation of Art 8 of the USD. The NRA may sometimes have an advisory role here.

In many Member States, the obligation of providing universal services still lies with the incumbent operator. This obligation often arises from legal provisions in national telecoms legislation based on the ONP framework. Such provision may e.g. say that the incumbent will have to provide universal services for a defined time-frame or until a certain date.

Stipulations which assign the provision of universal services to different providers on a regional basis only occur in a few Member States' national legislation.

Following the expiration of the designation time-frame specified in the Acts, the relevant legislation can specify that a process for designating a new USP is implemented – often to be coordinated either by the responsible Ministry or by the NRA.

The above-mentioned designation mechanism by rule of law is used in quite a few Member States who have fully liberalised their telecommunications markets by 1 January 1998.

Where the designation of a USP occurs directly as a result of legislation, the respective Member State has – in most cases – not sought to subdivide the universal service obligation for the purpose of allowing provision by multiple operators.

Existing designation periods in a number of Member States (which were implemented pre-introduction of the new framework) do not expire for a number of years. In such cases,

Member States may not immediately set up a new designation mechanism but will do so before the specified expiry date.

3.2.2. Administrative decision by Ministry/NRA

A similar designation mechanism is used if the competent Ministry or the NRA allocate the future provision of universal services for a predefined timeframe by administrative decision. In many Member States where this kind of model is used, the underlying legislation stipulates that the provision of universal services must be guaranteed and that the Ministry/NRA is entrusted with the decision to assign the USOs to that market participant which, in comparison to its competitors, offers the highest degree of reliability that the universal services offered will be properly provided.

The safe – and therefore attractive – option may be to designate the incumbent as the USO. However, this may not always be the best solution. The Ministry/NRA must therefore ensure that it has sufficient data about the market and other possible candidates to enable it to make an informed decision.

3.3. Designation by tender

The two options when tendering for the fulfilment of USOs are (a) auction and (b) beauty contest. The main difference is the criteria used to determine the winner of these designation mechanisms. While in an auction only the compensation payment is crucial in the election process, the beauty contest involves an assessment of the bids according to criteria which extend beyond price considerations (such as quality etc.).

Designation by tender is typically used in the presence of asymmetric information in which the entity issuing the tender disposes of less information on the value of the tendered service than the potential bidders. In the context of universal service the issuing entity has the obligation to ensure that a set of so-called universal services is provided. The costs associated with the obligation to provide the universal services are better known by operators than by the awarding authority.

Before designation by tender starts the elements to be awarded have to be completely identified and explicitly determined, including aspects such as the quality of services to be supplied, the area or customer group or the length of time in the contract.

The following section gives a brief description of these two most well-known procedures to tender universal services, auction and beauty contest, and demonstrates the advantages and disadvantages of each.

3.3.1. Auction

Under an auction the operator that offers to accept the obligation for the lowest subsidy would be awarded it.

Therefore another result of the auction, besides the awarding of the USP, is the maximum compensation that the participant will receive for his commitment to provide universal services (or parts of it).

An auction needs explicit rules and the fixing of a minimum bid, and also a maximum compensation in the case of a universal service auction.

Auctions can be designed in various ways, sequentially or simultaneously, single-round or multiple-round, open or sealed-bid. Also joint/ combined bids may be allowed.

There exist also different kinds of auctions, for example:

- The English auction is an ascending multiple-round and open auction. The participant who makes the highest bid (in the case of universal services, accepts the obligation for the lowest subsidy) receives the object (the obligation) for a price (compensation) equal to the bid.
- The Dutch auction is an descending multiple-round and open auction. The participant who first accepts an offer announced by the auctioneer is the winner. He has to pay the offer (will get that amount of compensation) that he accepts.
- Vickery-auction: This is a second-price sealed-bid auction. Each participant makes only one offer independent of each other and without knowing the bid of the others. The one who finally made the highest offer (claims the lowest compensation payment) is the winner. He has to pay a price (gets a compensation) equal to the second highest (lowest) bid.
- First-price sealed bid: This kind of auction is equivalent to a Vickery-auction except for that the winner has to pay a price (gets a compensation) equal to his bid.

Advantages:

A well-designed auction awards the bidder who claims the lowest compensation payment. Therefore an auction promotes the efficient allocation of the obligations. An additional advantage of the auction is the fact, that it determines the net cost of US through a competitive mechanism.

Disadvantages:

Auctions are not appropriate when the number of potential bidders is likely to be very small or when the reserve price is not known. An additional disadvantage is the fact, that at the moment (at least to our knowledge) no adequate auction design exists for the designation of universal services.

3.3.2. Beauty Contest

When applying a Beauty Contest the awarding authority is responsible for designing and running the award procedure. It decides which criteria should be used in the selection process, how they should be weighted and prepares the invitation to bid.

The applicants set out their cases for being awarded on the basis of this criteria of the invitation bid. Often they are also required to submit information in support of their application, this could include company details, description of services offered, roll out plans, business projections and costing.

The regulator follows up with applicants any points arising from their applications and then bases the allocations on the best business plans presented and the qualifications of the operators.

Although the national regulator is judging the quality of applicants' responses against the criteria of the invitation bid, it has the control over the selection process.

Advantages:

A beauty contest allows the nomination on the basis of detailed plans submitted by applicants.

Disadvantages:

The beauty contest approach is criticised because it places control in the hands of telecommunication regulators rather than the free market.

3.4. Matching criteria with principal designation approaches

3.4.1. Designation by “nomination”

3.4.1.1. Legal Instrument

Where the USO is assigned by legal instrument, eg an Act or ordinance, particular care may be needed to ensure compliance with the criteria set out in Article 8(2) of the USD. For example, whilst Parliament is bound to obey the rule of law and therefore must not act in a discriminatory manner, it may be questioned whether smaller operators who would, for example, have been interested in providing universal services in a particular region were properly considered. Public consultation may therefore be important in this respect.

3.4.1.2. Administrative decision by Ministry/NRA

Clearly, the Ministry/NRA must comply with due process requirements when deciding who should be designated as a USP and for which elements of the USO.

Concerning the criteria established in the article 8 of the Directive, the Ministry/NRA must obey the following principles:

All conditions established must serve objectively the general interest. In order to guarantee objectivity in the designation, there could be legally fixed objective criteria, taking into account operator's market share (to measure its dominant position), operator's income, etc.

Requirements established must lead to an efficient designation of the USO provider offering the most competitive price with regard to the conditions of the service offered (coverage area, quality of the service, etc).

A transparent designation mechanism must allow all operators in particular and the public in general to monitor the conditions required for awarding the USO.

The Administration's activity must serve objectively the general interest subject to the legal system in force. Therefore, conditions established must be applied to all operators in a non-discriminatory manner without exceptions so that universal services are provided to end users at the required quality.

3.4.2. Designation by tender

3.4.2.1. Auction

A properly-conducted auction can be classified as being non-discriminatory and objective, as the results of the auction are determined by the bids of the participants and all participants are facing the same rules.

An auction is also a relatively transparent mechanism (especially in comparison with a beauty contest – discussed below), given an explicit draft, proper publication of the relevant rules and the fact that the participants are familiar with the relevant rules..

In theory a well-designed auction will lead to an efficient result. For example simultaneous multiple-round auctions may allow to internalise information asymmetries to be internalised among participants of the auction and/or auctions with combinatorial bids may allow value interdependencies to be internalised. Nevertheless, as already mentioned, no such auction design for awarding the USO currently exists.

3.4.2.2. Beauty Contest

Clearly, beauty contest appointment must be in accordance with due process requirements when deciding who should be designated as a USP and for which elements of the USO.

A high degree of transparency, eg public consultation and early publication of the invitation to tender, the tender document including selection criteria for the USP and the decision on awarding the USO is particularly important (say to counter criticism that selection procedure may be less transparent and the awarding authority may not be sufficiently objective in its decision-making).

The tender document should also include objective conditions covering service features (quality etc.) and their respective importance.

Finally, an efficient designation mechanism shall measure the fulfilment of the objective requirements and the cost of the service proposed by each tenderer.

4. Mechanisms for designating universal service providers used by IRG countries and market impact

4.1. Current situation in IRG countries

In February 2003 a questionnaire regarding USO designation was circulated between the IRG member countries. Based on the input from the IRG member countries (Denmark, Finland, Germany, Greece, Ireland, Netherlands, Spain, Sweden, Switzerland, United Kingdom and Austria) the following can be concluded.

4.1.1 Designation authority

As mentioned above, the designation by rule of law is used in quite a few member countries who have fully liberalised their telecommunications markets by January 1., 1998.

However, it seems that, in the majority of the IRG member countries, the USP is designated by the NRA. Only in Spain is USP awarded by the ministry.

4.1.2. Designation mechanisms

As far as designation is concerned the Finnish legislation is quite unique; no USO-operator(s) is designated in Finland. The obligation to provide access at a fixed location is set in the Communications Market Act to the SMP operator (or secondarily to the operator with the biggest market share) in that particular area. The provision of other USO services is a common responsibility set out in legislation to every operator for its part..

In the other member countries there seems to be various combinations of the mechanisms described above.

An exception is the Netherlands where the USO will be awarded to the operator with the lowest net cost.

In Austria an auction will take place first and, without a tender, USO will be by obligation.

Greece has changed the designation mechanisms – where the incumbent traditionally has had the USO since liberalisation began, a competitive tender mechanism may be used instead in the future.

In the UK, designation has been based on published criteria satisfying the requirements described in Article 8(2) of the USD (objective, efficient, transparent and non-discriminatory).

These criteria were consulted upon in advance as was the proposed designation of two undertakings as USPs. Other parties were able to express their interest in the USO, and the designation authority was required to consider any such expression of interest (in fact, none were received).

Ireland also operates a designation mechanism similar to the UK. The NRA has re-designated the incumbent operator as the USP based on the criteria set out in Article 8(2) of the USD. The designation followed a detailed consultation process which set out the criteria upon which it was intended to designate the USP. A request for expressions of interest from alternative operators to become a USP was also made, however, no expressions were received.

In Norway the USP will be designated by the ministry based on the criteria described in the directives which are implemented in the new regulatory framework.

In Denmark the USP is designated on the basis of market share (combined with the the criterias described in the directives), but the legislation also opens up for a public tender.

Switzerland only operates with a beauty contest designation.

The German regulation also seems rather different from the regulation in the other member countries. Where – contrary to expectations - a universal service is not appropriately or adequately provided or there is reason to believe that such provision will not be ensured – a USO will be imposed on a USP. First, a voluntary solution, i.e. provision of the universal service without compensation, would be sought. Should there be no voluntary solution, the legislator gives two options: the USO may be imposed on the provider having a dominant position, or the USP will be designated following an auction.

4.1.3. Designation criteria

The relevant criteria for awarding the USO mainly depend on the designation mechanisms chosen. The main criteria seems to be the net costs of providing universal service. In addition the market share of the operator seems relevant, especially in the countries that deal with market analysis prior to designation.

4.1.4 Designation duration

Only in a few IRG member countries has the implementation of the USD been combined with a new designation under the new regulatory regime.

In Austria the new law requires a tendering of USO for the period after 31 December 2004, but not if there is only one undertaking which fulfils the business requirements of provision. In this case, the current USP will be obliged until a tender has taken place or another operator has been designated via obligation.

In the UK USO has not been awarded but USPs have been designated by the NRA under new directive-based legislation.

In Ireland, the USP has been designated with effect from 25th July 2003 for a period of three years.

In France, the current USP has been designated for an unlimited time-period by a provision of the Telecom Act of 26 July 1996.

In Denmark the USD has been implemented, but the current designation of USO has a duration of 10 years, which means that there will not be a new designation procedure before 2007. However, the USO provider can request NRA to change or review the appointment.

In Norway, the current USP will provide universal services until the initiation of new designation proceedings.

In Ireland the NRA has designated the former incumbent (following a consultation process) for a period of three years.

In Switzerland a new USP has been designated in 2002 for the duration of five years (2003 – 2007) by the NRA. Switzerland does not have to implement any of the Directives.

4.2. Implementation of the new framework

At the moment, EU member states have either already implemented or are implementing new legal frameworks regarding the transposition of the new directives into national law. The question of designating USPs has also to be addressed.

A questionnaire dated February 2003 and circulated between IRG members provides a quick overview how Member States are approaching the designation of USPs.

The definite mechanisms will be known within the next months, as legislation will be implemented in Member States.

4.3. Impact on market

It is difficult to evaluate the impact on the internal market – if any - of the use of different designation mechanisms used by Member States/IRG countries. If the criteria set out in Art. 8 (2) of the USD are met under the designation mechanism chosen, a priori no undertaking (even if not a national undertaking) is excluded from the possibility of being designated. In a national context, the final result is the same irrespective of the designation mechanism employed i.e. universal service is provided by at least one undertaking.

5. Conclusions

In evaluating a designation mechanism, the starting point is, of course, the criteria set out in Article 8(2) of the USD of efficiency, transparency, objectivity and non-discrimination.

As this report illustrates, the approach taken by Member States to designation (if, indeed, the Member State has decided that designation is necessary to ensure the provision of universal service) varies from country to country.

Some have chosen to impose designation by means of an obligation, for example a legal instrument or an administrative decision; others favour the alternative of a tender process, for example an auction or beauty contest.

At the time of writing, however, there is little practical experience within the Community of designation by means of tender. This is likely to change over the coming years. In the meanwhile, it is premature to consider one means of designation over another as being more consistent with the principles embodied in Article 8(2).

However, the importance of transparency of the designation process cannot be overstated. It is perhaps not enough that the Member State complies with the Article 8(2) criteria, it should also *be seen to comply*. Procedural openness, such as early consultation on the intended approach and widespread publication of the final decision, is therefore important.