

COAI Response on the TRAI Consultation Paper on ADC Regime, July 14, 2004

Access Deficit Charge (ADC) Regime: General Comments

1. Internationally, the fundamental principle of calculating ADC is that it is the difference between the actual cost of providing service and the mandated lower tariffs for providing subsidized Access Services to a class of subscribers. The TRAI also concurs with this concept and in its Consultation Paper on ADC on Page 4, Para 1 explains ADC as: **“Access Deficit arises when the tariff specified for access does not cover the cost of providing access”**.
2. In India, **with the forbearance of PSTN tariffs for urban and semi-urban subscribers, based on international principles, ADC should be worked out for the actual number of subscribers in the rural areas only (about 8-10 million) where the standard tariffs mandated by TRAI are applicable.** TRAI in its analysis of the reasons for lower share of ADC in the total sector revenue in other countries (paras 7 & 8 of the Explanatory Memorandum of IUC Regulation 2/2003), as compared to India, has stated that it is due to tariff rebalancing having been achieved to a substantial degree before liberalization of telecom sector in these countries. At the same time TRAI seems not to have taken into consideration the tariff forbearance for urban and semi-urban subscribers, which tantamounts to tariff rebalancing, and thus there is no justification for working out ADC for the entire subscriber base of about 40+ million lines of BSNL. There is also no justification for ADC to be even considered to be given to MTNL and private FSP's/UASL operators who are not providing any services in the rural areas where TRAI's prescribed tariff package would be mandatorily applicable.
3. First & foremost, as already stated in our earlier communications, we wish to reiterate that BSNL does not have any Access Deficit. There is simply no evidence of this from their operational results year after year, which are continuing to show healthy surplus. The latest Annual report of BSNL for year 2002-03 shows that even in the highly competitive telecom market existing in India today, **BSNL has made a surplus of over Rs 1400 cr and thus should not be a recipient of ADC unless there is financial data demonstrating deficit in rural fixed access business** after accounting separation of BSNL accounts into licensed service categories.
4. Other than rural areas, the Authority has prescribed tariff forbearance in all retail tariffs. In such a scenario, **inability of BSNL to rebalance urban access tariffs towards cost oriented rental either due to market compulsions or political reasons or probable operational inefficiencies cannot be a reason** for burdening the other access providers specially

severely competitive cellular sector whose operating margins are constantly under pressure. Further regulatory burden of ADC will seriously affect their expansion programmes.

5. In para 1.2. of the consultation paper it is mentioned that in most of the countries, the funding of the access deficit has been merged with the USO programme. It is further mentioned that in India also, the aim of the Authority is to finally move towards such a regime. The Authority has already modified ADC regime twice in the last one year, & a third change is now contemplated. We feel that since USO also caters to the same requirement i.e. funding of telecom services in rural areas, and a fund has already been established with an independent administrator it would be appropriate to straight away merge ADC with USO instead of any more transition stages.
6. Since BSNL, who is going to be the only beneficiary of ADC, is an integrated telecom service provider, providing all types of telecom services including CMTS, it is essential that accounting separation is implemented in BSNL, forthwith so as to determine correctly the extent of deficit in providing rural access services. Till the accounting separation is done, and the deficit is actually established, particularly in the context of their huge profits year after year, there should be no disbursement of ADC to the BSNL.
7. There is still no evidence of Accounting Separation in BSNL and this is the fundamental prerequisite to be able to first demonstrate that the access call business of BSNL is having any deficit at all that is attributable to TRAI mandated tariffs. Lack of accounting separation and huge contribution of ADC by the Cellular Mobile Operators to its competitors, is resulting in great competitive disadvantage for the private cellular mobile service providers as BSNL is a major CMTS player and a competitor in all circles.
8. Since there is tariff forbearance for fixed line services, except in rural areas, the Access Deficit should be worked out only for about 8-10 million lines in the rural areas instead of for the total fixed lines of 45 million. With this the quantum of ADC may get reduced to about Rs. 500 –Rs.600 crores or less.
9. No, ADC should be levied on Access Services, as this will result in increase of tariff for access, which will be against the government's objective of rapidly increasing the teledensity. It will also be against the basic concept of Access Deficit, which generally arises due to cheaper & below cost access services.
10. In the consultation paper it is estimated that the total number of telephones at the end of March'2005 (mid point of the implementation period October'2004 to September'2005 of the proposed revised regime) would be fixed lines 45.28 million and mobiles 57.98 million. It is also estimated that based on the

average ARPU of Rs. 525/- per month, the total industry's revenue would be about Rs.65,000 crores. However, this does not take into account the ILDO's revenue on account of incoming ILD calls. The TRAI's revenue estimate, therefore needs to be corrected.

11. Total revenue of NLD/ILD sector is about Rs.20,000 crores (30% of total revenue). If the ADC is restricted to the deficit for rural access only, the ADC of about 3% of the NLD/ILD revenues will suffice to cover the entire gap.
12. The ADC should be phased out in next 2-3 years and there should be no ADC beyond March' 2007.
13. The ADC should be paid only to BSNL. There should be no ADC payable to MTNL or private BSOs. Private BSO's networks are mostly wireless based, having much less capex per line than the wireline based PSTN network of BSNL.

The above forms part of the answers to TRAI's questions in the consultation paper and our answers to the said questions are subject to above observations.

Answers to Questions raised in the Consultation Paper

1. While there is no shortcoming as regards the application of the principle of revenue share basis for ADC as proposed in the TRAI consultation paper. However the continuation of ADC regime shall have following implications;
 - » **will result in a sort of Cess on the Access Services and tend to increase their tariffs.** This will be against the fundamental objectives / principle of ADC which arises due to providing cheaper and below cost Access Services and cross subsidizing the same from other Telecom Services.
 - » **It should be merged with USO regime, as been done in other countries.** Instead of having one more transition we should straight away move to the final objective of funding the telecom services in rural areas through USO fund only.
2. The ADC funding under the proposed regime should be provided only to the BSNL. The other incumbent MTNL, is providing services only in Delhi & Mumbai, the two biggest metros in the country. More over it has no rural presence. Similarly private FSPs/UASLs are not providing any services in the rural areas where TRAI's standard tariff package would be mandatorily applicable. Moreover all the private FSPs have now migrated to UASL regime, under which there is no rural roll-out obligation.

There is no justification in not charging ADC from other FSPs / UASL operators on the ground that they are not being provided any ADC support.

The UASL operators are now providing primarily cellular mobile services, and fixed services are being provided to corporates & high end customers. Infact the ARPUs of such fixed lines provided by private operators are atleast 2-3 time higher than the average industry wide ARPUs of Rs.525/-.

3.

- (i) The projected industry revenues of Rs 65,000 crores do not include the revenues accruing to the international long distance operators on account of incoming international calls. The industry revenue estimate has to be increased upwards for the same.
- (ii) The IUC Regulation 2/2003, Explanatory Memorandum, in Para 44 states “that of the total CAPEX and OPEX, only 93.6% is taken for the purpose of the IUC exercise. Since cellular mobile is part of the telephony service, further adjustments were made to remove the costs attributable to cellular mobile based on the segmental cost statements submitted by BSNL.” However in building capital employed for projected years, the capital works in progress (CWIP) account has been considered without segregating it into that for fixed access and other BSNL businesses specifically cellular on which BSNL has been spending significant amounts for launch and expansion of services.
- (iii) In Para 3.8 in the Consultation paper under discussion, it is mentioned that the lower WACC used has been replaced by normal WACC due to government grants & concessions made to BSNL being no longer effective. However, in our opinion while direct government grants to BSNL may have reduced, the implicit grants provided via free of cost/ concessional use of government/public funds continue and need to be considered and quantified and added to the “Government compensation” line item in the Net access deficit calculation.
- (iv) Revenue from equipment, personnel & other related infrastructure at commercial transfer pricing (and not on historical/actual basis) rates apportioned to BSNL access services but available to other service lines of BSNL (Mobile, WLL, Internet, corporate Data etc) should also be netted off from the ADC estimates . E.g. The use of building in prime area for use by basic access service lines as well as for WLL and mobile services of BSNL.
- (v) On Page 6, (Para 58 of the Explanatory Memo attaching to IUC Regulation dated 29th October, 2003) TRAI acknowledges that “..BSNL and MTNL...have benefited on account of being allowed entry into cellular mobile without any entry fee. The Authority also hopes that the deficit would be made good by the profits of these

organizations...”. The current paper does not take into account the benefit that has accrued to the incumbent on account of free entry and the consequent reduction in access deficit. The higher revenue share amount therefore applied to the entire industry, in our opinion, is like a cess on the telecom industry that will eventually get passed on to the subscribers in terms of higher tariffs and will have a negative impact on the growth and spread of telecom uptake and services in the country.

- (vi) In the Consultation paper under discussion the regulator has provided estimates of the net ADC to be funded with two options at rental recovery estimated at Rs 200 and Rs156 while noting that “...there is now a possibility of high rentals in view of tariff forbearance by the Authority..” and “...there are a number of tariff schemes with higher monthly rentals”. Since the tariff for urban and semi-urban areas is foreborne, ADC should be worked out only for the rural phones, i.e. about 8-10 million lines only. In our assessment the total ADC for rural phones based on mandatory tariff would not be more than Rs. 500 – 600 crores.
- (vii) The payment of ADC under revenue share basis will be a pass through charge , and therefore should be deducted from the gross revenue while calculating adjusted gross revenue (AGR) for the purpose of calculating licence fee.
- (viii) While calculating the amount of ADC, unutilized funds already available with the USO fund should be taken into account.

Other Issues

1. The revenue share regime shall be effective and meet its objective if the principles of netting off are applied by all the parties including BSNL and previous period settlements are made immediately. Else the problems related to ADC shall continue.
2. **ADC should be performance linked** with a TRAI specified rollout of rural lines. This is necessary because inspite of the huge cross subsidies enjoyed by BSNL in the past, rural lines are still only about 20% of total lines. This would be easily implemented if ADC is merged with USO regime.
3. The ADC should be merged with the USO funds, as the latter has been clearly developed for funding the telecom services in the rural areas. Imposing ADC on the Access Providers would be double taxation on them. However incase Authority proposes to continue levying of ADC on the access services, the sunset date for ADC should be clearly specified. Instead of a mentioning it as a time period of 3-5 years in the current Consultation paper, we suggest that there should be **no ADC beyond March, 2007**.