MALAYSIAN COMMUNICATIONS AND MULTIMEDIA COMMISSION

A REPORT ON PUBLIC INQUIRY UNDER SECTION 65 OF THE COMMUNICATIONS AND MULTIMEDIA ACT 1998 ON LOCAL ACCESS FUNDING

31 July 2002

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TABLE OF CONTENTS

ABBREVIATIONS

IP	Internet Protocol
ISP	Internet Service Provider
LAF	Local Access Funding
MCMC	Malaysian Communications and Multimedia Commission
NERA	National Economic Research Associates
TMB	Telekom Malaysia Berhad
USO	Universal Service Obligation
USP	Universal Service Provision

GLOSSARY

The Act	The Communications and Multimedia Act 1998.
Net USP cost	The loss incurred by a universal service provider from supplying services to a universal service area in the course of fulfilling the universal service obligation.
Universal Service Obligation	The obligation to ensure that the universal service objectives in respect of an area are fulfilled
Universal Service Provider	A provider designated by MCMC as a universal service provider in respect of an underserved area or group within the community with responsibility to take all reasonable steps to fulfil the universal service obligation so far as it relates to that area.
Universal Service Provision Fund or USP Fund	A fund established under section 204 of the Act.

SECTION 1: SUMMARY

1.1 Introduction

1.1.1 The Determination of Cost-Based Interconnection Prices and the Cost of Universal Service Obligation or TRD 006/98 introduced the concept of Local Access Funding as a mechanism to fund any increase in the net cost of universal service provision arising from the introduction of equal access. This determination required the government to determine equal access operators' contribution to the Local Access Funding (LAF) and to review it on a yearly basis or as and when the need arose.

1.1.2 Key features of the LAF mechanism are that:

(a) Equal Access providers alone have to contribute;

(b) only local access network operators providing universal services receive funding; and

(c) the cost of LAF is to be determined by the Director General of JTM.

1.1.3 The Malaysian Communications and Multimedia Commission (the Commission) has embarked on a process to review Local Access Funding mechanism and for this purpose has engaged National Economic Research Associates (NERA) to assist the Commission. This review has been prompted by the recent introduction of a new Universal Service Provision (USP) Determination, which replaces the previous Universal Service Obligation (USO) system on which the LAF mechanism is based.

1.2 Public Inquiry

1.2.1 In order to ensure that the review of LAF is carried out in a transparent manner, the Commission embarked on a public inquiry process on 13 May 2002.

1.2.2 The closing date for submissions was at 12 noon, 1 July 2002. At the close of the inquiry, the Commission received five submissions from the following parties:

(a) Celcom (M) Berhad (Celcom);

(b) Digi Telecommunications Sdn Bhd (Digi);

(c) Maxis Communications Berhad (Maxis);

(d) Telekom Malaysia Berhad (TMB); and

(e) Time dotCom Berhad (Time).

1.3 Public Inquiry Report

1.3.1 With respect to the Public Inquiry process, the Commission is under an obligation to issue a Public Inquiry Report under section 65 of the Communications and Multimedia Act 1998 (the Act), setting out the findings of the Inquiry.

1.3.2 This Report is issued in conformance with the requirement of section 65 of the Act.

1.4 Structure of Report

1.4.1 This public inquiry report is structured in the following manner:

Section 2 discuses the submissions received and the Commission's response on revocation of the LAF mechanism and the issue of access deficit;

Section 3 discuses the submissions received and the Commission's response on the current sources of funds available to TMB to recover any access deficit;

Section 4 discuses the submissions received and the Commission's response on how the access deficit should be defined and calculated;

Section 5 discuses the submissions received and the Commission's response on other rationales for the recovery of the access deficit; and

Section 6 discuses the submissions received and the Commission's response on how an access deficit funding mechanism might work, if one were to be set up.

Section 7 provides conclusions and recommendations with regards to the subject matter of Local Access Funding

SECTION 2: REVIEW OF CURRENT LOCAL ACCESS FUNDING MECHANISM

2.1 Introduction

2.1.1 As noted in Section 1, the aim of the current LAF mechanism is to fund any increase in universal service costs arising from the introduction of equal access. Under the TRD 006/98 regime, only TMB was obliged to offer universal services. Therefore, other non-universal service operators were not entitled to receive any LAF payment.

2.1.2 The Commission has now introduced a new system for universal services, the Universal Service Provision (USP) system, which consists of two phases. Phase 1 provided for TMB to continue to be the sole provider of universal services from 1 January 2001 until 31 December 2001. Under Phase 2, The Commission may designate a licensee other than TMB as universal service providers.

2.1.3 The new USP system is entirely separate from the previous system and all licensees[1] are now required to contribute 6% of their weighted revenue (the "contribution" into a USP Fund, unless The Commission decides otherwise. There is therefore a separate and explicit funding mechanism that the Commission can use to fund the net USP cost.

2.1.4 Under the new USP regime, TMB will no longer be able to claim any net Universal Service Obligation (USO) on existing lines. This will in effect make the LAF mechanism, as defined by TRD 006/98, obsolete. There is, therefore, a need to review the current LAF mechanism.

Question 1

Do you believe that the current LAF mechanism should be revoked? Please explain your answer.

Comments on the relevance of revoking the current LAF mechanism:

We summarize below the comments received on this issue:

- Celcom is agreeable to the revocation of the current LAF mechanism. Celcom is of the view that the annual contribution of 6% of the licensee's weighted revenue as determined by the Commission Determination on Universal Service Provision Determination No. 2 of 2001 should cater for the Universal Service costs. In addition to the contribution to the USP Fund, Celcom

[1] Except content applications service providers; holders of registered licenses under the Broadcasting Act 1988; and those whose total revenue derived from designated services in a calendar year is less than RM 500,000.00

noted that it still has to bear the interconnection charges including the leased circuits rental and charges.

- Digi is agreeable to revoke the LAF mechanism and has indicated that following the latest tariff increases for local calls and rental fee, it did not believe that there was any access deficit to be recovered. Digi also noted that new fixed network service providers providing long distance services through equal access (EA) have been severely disadvantaged through a requirement to over-compensate TMB for its USO cost, even though TMB's revenue loss attributed to USO has not been exacerbated by loss of market share owing to EA (The aim of the current LAF mechanism was to fund any increase in universal service costs arising from the introduction of EA). Digi also noted that it is not economically efficient to use a mark-up on cost-based interconnection charge to fund any access deficit. Digi recognized that access deficit could only potentially arise when the cost of providing ordinary exchange lines to customers is greater than regulated connection and rental revenue. Digi believes that the customers for which access deficit could arise are also customers who contribute to TMB's other lines of business (STD and IDD calls), providing an incentive to TMB to provide access to them.

- Maxis believes that there are valid arguments for the current LAF mechanism to be reviewed, leading to its revocation. Maxis believes that the recent increase in rental and local call tariffs will reduce the size of the local access deficit. Maxis also provided 3 other reasons to revoke the LAF mechanism: (i) the precise amount of the local access deficit cannot be ascertained and it will change over time; (ii) local access funding can reduce demand for the services on which it is levied services in a disproportionate manner (because of higher price elasticities than for access services), hence contributing to economic inefficiency and (iii) the difficulty in detecting and measuring minutes of traffic that should contribute to LAF (in particular, IP telephony) will make the collection increasingly difficult, and unfair to the PSTN operators. Maxis also commented that some regulators have recently rejected or reformed the ADC regimes. Maxis noted however that if there is indeed a pressing and justifiable need to maintain an LAF mechanism in Malaysia, then the charge should be reduced to less than 10 sen per minute.

- TMB is of the view that the LAF mechanism is not adequately compensating its access deficit. TMB pointed out that the current price of line rental and fixed network connections are below cost and TMB is constrained in its pricing by the rate regulation. TMB also commented that the advent of EA, prepaid calling cards, and VOIP had undermined its ability to cross-subsidize its access deficit (margins are squeezed on existing business and profitable calls for STD/IDD calls are lost to competition). TMB further commented that the new USP regime would not allow the recovery of the access deficit and that LAF revenues had declined over time as EA operators have found opportunities for by-pass (avoiding payment of the LAF fee).

- Time agreed to the revocation of the LAF mechanism in light of the fact that (i) operators will be contributing 6% of revenue to the USP fund (ii) any licensee may opt to undertake the approved USP and claim allowable expenses from the USP fund (iii) actions and impediments placed in way of EA have prevented EA to take off (iv) recent increases in charges for business and residential lines helps TMB to recover its investment on access faster.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the consensus in the industry for the revocation of the current LAF mechanism. The Commission is therefore of the view that the LAF mechanism should be revoked.
- The Commission also takes note of the fact that all operators but TMB are of the view that there is no need for an Access Deficit compensation to be implemented. The Commission also takes note of the fact that TMB claims it is still not able to recover the cost of providing lines with the current regulated fixed connection and rental tariffs while its ability to cross-subsidize is increasingly limited.

2.2 Implications of revoking the LAF mechanism

2.2.1 TMB was the only operator to receive revenue under the LAF mechanism. If this mechanism is revoked, the question arises as to whether TMB would face an access deficit in relation to existing lines (new universal service lines would be funded through the USP Fund) due to the loss of both USO contributions and the LAF mechanism.

2.2.2 In principle, the Commission considers that the implications of revoking the LAF mechanism on access deficit issue should be examined. However, assessment of the implications is not a straightforward matter because:

(a) TMB already has a number of opportunities to recover any resulting access deficit from other sources; and

(b) The Commission does not have any evidence on the size of any access deficit.

Question 2

MCMC invites comments as to whether it should consider the issue of access deficit in Malaysia in the light of any revocation of the LAF mechanism.

Comments on whether MCMC should consider the issue of access deficit in Malaysia in the light of any revocation of the LAF mechanism:

We summarize below the comments received on this issue:

- Celcom believes that since there is no evidence on the size of any access deficit and contribution made to TMB has yet to be audited, access deficit should not be considered in Malaysia.
- Digi believes that the access provider should not be forced to make an overall loss on the customer. The Commission should take into account that many customers on which the access loss is made are highly profitable for other lines of business, such as long-distance and international calls, and that the access provider may have an advantage in the provision of these services. As such, if a customer is economic when all costs and revenues attributable to that customer are considered, then there should be no compensation. Digi also noted that (i) there should be no issue of access deficit particularly with tariff rebalancing and (ii) under the new USP regime, a universal service provider is sufficiently compensated for the cost of serving uneconomic customers.
- Maxis noted that the issue of access deficit should not be considered as per its answer to Question 1.
- TMB commented on the difference between the issues of LAF (as implemented in Malaysia), USP (as implemented in Malaysia) and access deficit. It concluded (as the Commission did in its consultation Paper) that there are not the same. It also concluded that therefore there is a need to implement a compensation for the access deficit. TMB also noted the particular case of Malaysia with the following particularities: (i) need to create appropriate incentives for rapid fixed network roll-out and the most efficient use of investment capital to address low penetration levels (ii) low GDP per head which raises the issue of affordability (iii) the difficulty to implement rapidly retail rate rebalancing (discourage greater penetration and may lead to loss of existing customers).
- Time noted that there are other opportunities for TMB to recover access deficit with the new tariffs for local calls and rental charges. Time also suggested that a comparison of TMB's profit level before and after implementation of EA in order to access the on turnover.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission would like to remind the industry that the USP regime is aimed at compensating operators for fulfilling their USP obligations by the roll-out of new lines. Therefore, USP does not cover any access deficit that may arise from existing lines.
- Without a mechanism for the compensation of access deficit in place, other operators would be able to attract customers from the access providers for profitable services (namely STD and IDD calls) while the access provider would still have to bear any access deficit it may incur from these customers who place their profitable calls through other operators.
- The Commission takes note of the fact that some operators believe the size of the access deficit cannot be determined accurately. However, the Commission does not accept this argument to determine that no compensation should be made for access deficit.
- The Commission takes note of the fact that all operators (in their answers to Question 1 and 2) except for TMB believe that the latest increase in tariffs for rental and local calls now allows TMB to recover its access costs. The Commission also notes that TMB believes otherwise. Although the Commission does not have all the necessary data to form a definitive view on whether TMB would be likely to have an access deficit, it suspects that the increase in the said tariffs may still not allow a fair recovery of the costs of the access network.
- The Commission agrees with the views of TMB that there is a need to create appropriate incentives for rapid fixed network roll-out and efficient use of investment capital to address low penetration levels. The Commission is committed to implementing the right instruments for that purpose. The Commission understands that not allowing TMB a <u>fair</u> recovery of its costs (including an access deficit if any) would force TMB to prioritise customers and possibly neglect uneconomic areas. It may however be difficult for the public to accept this view when super profits, as seen in TMB's 2001 accounts, are observed.
- The Commission would like to point out that due to the lack of data from TMB, the Commission has not been able to form a definitive view[2] on whether other sources of profits[3] fully allow the recovery of any access deficit.
- Based on the above analysis, the Commission is minded to consider the issue of access deficit. However, the Commission is strongly of the view that the burden of proof is now on TMB to demonstrate the existence of an access deficit which it cannot recover.

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[2] The Commission has nevertheless derived its own internal preliminary estimates based on what it believes are fair assumptions of the missing information.

[3] based on excessive profit for other line of business (excessive profit being defined as the economic profit in excess of the rate of return required by shareholders and providers of capital)

SECTION 3: ALTERNATIVE SOURCES FOR RECOVERING AN ACCESS DEFICIT

3.1. Cross-subsidization from profitable call services

3.1.1 Under the current regime, TMB is able to recover its access deficit (and any losses on local and Internet calls to 1515 and 1511 services), through the following two main sources of funds:

(a) cross-subsidization from profitable call services; and

(b) high interconnection charges.

3.1.2 TMB has been able to generate revenues well in excess of its costs for some key services (national calls, calls to mobile phones and international calls). This is mainly due to muted competition in the fixed line business, regulated rate ceilings for national calls and until recently, the existence of a price floor for national and international calls.

Question 3

Do you agree that these alternative sources of funds also need to be taken into account when considering the impact of any revocation of the LAF mechanism?

Comments on alternative sources of funds:

We summarize below the comments received on this issue:

- In line with its view that the issue of access deficit should not be considered to start with, Celcom indicated it was not agreeable to taking into account the alternative source of funds other than utilizing the USP Fund for the purpose of USP costs.
- Digi is of the opinion that these alternative sources of funds need to be reviewed and taken into account when considering the revocation of the current LAF mechanism. Digi recommended that a clear definition of access deficit be established, noting that (i) a study should be undertaken to identify the cause of revenue losses (and/or any other mitigating factors) due to the provision of access and (ii) the source of such funds and the mechanism to compensate the access provider should be further investigated.
- Maxis agreed that these alternative sources of funds should be considered, especially where additionally, TMB has continued to take advantage of non-cost based interconnect charges being imposed, e.g. for premium services.
- TMB commented that an access deficit that is caused largely by price controls may be sustainable through cross-subsidisation

before market liberalisation. After liberalisation profits may be insufficient to financially sustain the net loss-making customers. TMB disagrees with the Commission's suggestion that "TMB in particular is able to recover its access deficit (and any losses on local and Internet calls to 1515 and 1511), through…cross-subsidization from profitable call services and high interconnection charges". TMB considers that a considerable proportion of customers choose to use OLNOs for national and international calls. Furthermore, TMB is of the view that the margins on the "key services" such as national and international calls have, and will continue to be substantially eroded as competition increases and with the emergence of VOIP operators. Whether or not TMB makes a net loss on a given customer, those customers which incur an access deficit are less profitable to TMB on the whole, thus placing an unfair burden on TMB's ability to complete with OLNOs in the provision of other services.

- Time agreed that the alternative sources of funds should be considered, noting that this is evidenced by level of annual profits shown by TMB and the strong confidence expressed by TMB that profitability margins could be maintained despite the drastic reduction in retail rates. Time therefore believes that there is ample cross-subsidy potential to cover the claimed access deficit.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the fact that 3 out of 5 respondents consider that the alternative sources of funds as described in the consultation paper should be taken into account when considering the impact of any revocation of the LAF mechanism.
- The Commission would like to point out that it is yet to be presented with any evidence that liberalization has endangered the profitability of TMB to the point that profits were insufficient to sustain financially the net loss-making customers or placed an unfair burden on TMB's ability to complete with OLNOs in the provision of other services.
- The Commission is therefore of the view that the alternative sources of funds as described in the consultation paper should be taken into account when considering the impact of revocation of the LAF mechanism.

SECTION 4: CALCULATING AN ACCESS DEFICIT

4.1 Definition of Access Deficit

4.1.1 An access deficit arises when the cost of providing ordinary exchange lines to customers cannot be recovered through connection (both new connections and reconnections) and rental revenues.

4.1.2 Therefore the access deficit can be defined as set out Box 2 below.

Box 2: Access Deficit

Access deficit = total connection revenue + total line rental revenues – cost of providing access network (ordinary exchange lines).

4.2 Calculation of the access deficit

4.2.1 It is important that if an alternative funding mechanism is to be set up, the access deficit is calculated using costs that would be incurred if the licensee(s) who operate access network were **relatively efficient**. This estimated cost figure would be lower than actual access deficit of a licensee who operates access deficit.

Question 4

Do you agree that where an access deficit is calculated for funding purposes, the relevant standard is the access deficit of an efficient operator? Please explain your answer.

Comments on the relevant standard for calculating the access deficit:

We summarize below the comments received on this issue:

- In line with its view that the issue of access deficit should not be considered to start with, Celcom disagreed with the statement.
- Digi agreed that where an access deficit is calculated for funding purposes the relevant standard is the access deficit of an efficient operator. However Digi pointed that whether an access provider (TMB or any other provider) exhibits costs of an efficient operator needed to be established before introducing a compensation scheme. Digi is also of the opinion that in order to decide whether or not an access deficit funding mechanism is needed to replace the LAF mechanism, it is crucial to first determine the extent to which TMB has incurred an access deficit. Since the Commission

has indicated that it does not have the necessary data to assess whether TMB would be likely to have an access deficit, Digi proposed that the Commission require that TMB demonstrates whether call charges are able to subsidise connection and rental fees and thus assess the extent of a deficit if any.

- Maxis reaffirmed its view that the 'external' funding of the access deficit is an economically inefficient mechanism, but agreed, for academic purposes, that where an access deficit is calculated for funding purposes, the relevant standard is that of an efficient operator. The calculation should be based on an efficient operator and not solely based on the incumbent, which, Maxis believes, has a lot of wastage and is an inefficient operator.
- TMB agreed that an efficient operator standard should be applied, provided that the operator is operating in similar circumstances and with similar constraints as TMB. Indeed, TMB believes it is inappropriate to apply efficiency benchmarks from developed country operators to Malaysia.
- Time agreed that the access deficit of an efficient operator is relevant, noting that (i) it will act as a catalyst for the incumbent to improve its efficiency and competitiveness, (ii) new entrants should not be made to contribute to any inefficiencies of the incumbent and (iii) it eliminates any dissatisfaction within the industry by using an international standard.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the fact that 4 respondents out of 5 broadly agree that where an access deficit is calculated for funding purposes, the relevant standard is the access deficit of an efficient operator.
- The Commission is of the view that the use of benchmark from developed countries can be intelligently used on a case-by-case basis, provided it is relevant for the exercise (for instance, to estimate an efficient level of indirect costs) and provided it does not result in an unrealistic target.
- As rightly suggested by Digi, and in line with the comments made for Question 2, the Commission is of the view that the burden of the proof is with the operator claiming to incur an access deficit.

4.2.3 In addition, it is important that if other licensees are required to contribute towards TMB's access deficit, then the calculation of TMB's access deficit should be transparent and audited.

Question 5

TMB and any other licensees with an access network that believe they are likely to face an access deficit are requested to provide MCMC with their data and calculations. A breakdown of annualised capital and operating costs should be provided, along with cost of capital and depreciation calculations.

Comments on MCMC's request to provide data and calculations:

We summarize below the comments received on this issue:

- Celcom is agreeable to the proposal.
- Digi agreed with the proposal. Digi commented that all users of the access network should make contributions to the cost, be they providers of basic or enhanced services that do not have equivalent obligations, yet receive profit from voice services through the access network. Digi also suggested that any other unfair competitive that enhances the position of the access provider should also be taken into account (for instance, the lack of flexibility in pricing for some market segments, in particular international communications with TMB capping of 20% against a floor price). Digi also requested that the Commission consider waiving contributions as long as licensees retain a certain minimum market share. Digi also insisted on the importance of transparency, noting that an independent auditor needed to be consulted in assessing the claims of access deficit and the accounts published for public scrutiny.
- Maxis indicated that if there was indeed a genuine and justifiable need for LAF, they agree with the Commission's suggestion in order to provide transparency and that payment should be based on the contributory /causation percentage of the local access deficit.
- TMB indicated that it was currently undertaking a detailed assessment of the quantum of its access deficit and that the results would be provided to the Commission once the calculations were finalised.
- Time commented that it did not believe that there is an access deficit in TMB or any fixed network operator after the recent tariff revision.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the fact that 4 respondents out of 5 broadly agree with the proposal.
- The Commission is pleased to learn that TMB will be a detailed assessment of the quantum of the access deficit.
- The Commission shares the views expressed by Digi that unfair advantages that enhance the position of a claimant should be assessed and taken into account where relevant. This rational is further developed in the next section.

SECTION 5: RATIONALE FOR THE RECOVERY OF THE ACCESS DEFICIT

5.1 Introduction

5.1.1 In this section, the Commission considers whether there are other rationales for funding licensees' access deficits. The following issues are considered:

(a) the difference between a monopoly and a competitive environment; and

(b) existing constraints on the retail rates (as this has an impact on the size

Question 6

Do you believe that a separate rationale for access deficit funding exists, as set out above? Please explain your answer.

Comments on separate rationale for access deficit funding:

We summarize below the comments received on this issue:

- Celcom commented that there is no separation of fund for access deficit funding.
- Digi indicated that it did not believe that a separate rationale for access deficit funding existed as set out above although it agreed on some of the points raised in the consultation paper. Digi was of the view that operators should not be forced to make an overall loss on the customer, without fair compensation. At the same time the other operators using the access network should not be made to over compensate the provider. Digi concluded that a clearly defined, efficient and transparent mechanism should be established to ensure fair competition for the benefit of the end users. Digi further commented that the Commission should take into account that the usage of access deficit has been particularly controversial in recent years and urged the Commission to examine the case against access deficit. Digi was of the view that access deficit is simply an artefact of accounting practices.
- Maxis agreed that there was a separate rationale for access deficit funding. Maxis quoted the example of VOIP providers who enjoy very attractive retail prices and retain high margin because they do not have huge network costs in their business model. Maxis noted, however, that in the case of PSTN voice providers, the retail "price floor" for fixed call charges would not put TMB at a disadvantage since competing PSTN operators would not be able

to undercut TMB on the pricing, which would not render their services to be any better off or more attractive than similar services offered by TMB. Therefore, TMB would not lose much traffic to them. In the absence of an access deficit charge and where interconnection charges would be truly cost-based, an inefficient competitor would gain in the short-run, but in the long run, they would be forced out of the market due to competition. Maxis also commented that if the Commission determined that the LAF or a similar mechanism was to be maintained, it should be tied to the long distance or international calls that are made via indirect access (i.e. only when TMB is unable to cross subsidize their access deficit) to ensure that competing operators would not end up having to fund the entire access deficit cost of TMB.

- TMB broadly agreed with the rational presented by the Commission. TMB further noted that in Ovum's report on interconnection and USO[4], Ovum suggested that countries with partly built networks and low teledensities should consider two arguments that make the case for access deficit stronger (i) there was an economic case for subsidising line rentals as they serve to encourage users to join the network more quickly and increase call completion opportunities for existing network users and (ii) investing in access networks was the top priority in countries with low teledensities. Without access deficit contribution, there was a danger that the new entrant will skim the highly profitable long distance traffic, removing the profit required by the incumbent to fund the building of new lines.
- Time did not fully agree with the rationale as incumbent may always have the cost advantage compared to new entrant as a large portion of their network costs are already sunken. Time also mentioned that TMB also retained deposits from customers which in fact is funding at subsidised rates.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the fact that 3 respondents out of 5 broadly agree to some extent that there is a rationale for separate access deficit funding, provided it is clearly and fairly assessed.
- In view of the comments by TMB, the Commission would like to point out that:
    - Allowing TMB to receive more revenues in the form of access deficit contributions only makes sense if it translates into the objectives described by Ovum above. However, it would not make sense if these contributions merely boost profit instead.

[4] Ovum, *Interconnect - a global guide to effective telecommunications*, London, 1997

  - The Commission is yet to be presented with evidence of large scale "cream skimming" in the fixed market in Malaysia.

- The Commission shares the view of Digi that the principles of fairness, transparency and efficiency are crucial.
- Based on the above analysis and after considering the comments received, the Commission still believes that there is a rationale for a separate access deficit funding but also believes that any advantages or disadvantages derived or incurred because of existing entry barriers should be taken into account.

SECTION 6: MECHANISMS FOR FUNDING ACCESS DEFICITS

6.1 Introduction

6.1.1 In the Consultation Paper that was released on 13 May 2002, the Commission has solicited views on the advantages and disadvantages of opting for:

(a) an additional per minute charge on top of certain interconnection charges (originating and/or terminating charges); or

(b) a lump sum contribution, which would allow operator to choose how they recover their contribution.

Question 7

Which type of mechanism (per minute or lump sum) do you consider preferable and why?

Comments on contribution mechanism:

We summarize below the comments received on this issue:

- In line with previous comments, Celcom believes there is no need for a contribution mechanism.
- Digi prefers a mechanism that charges on a per minute basis so that (i) the cost to an equal access provider is transparent, and (ii) the amount of contribution to be billed to each operator is clear, both to the access network provider and the equal access operator. Digi further commented that the per minute contribution could be more accurately targeted to the cause of the loss.
- Maxis was of the view that if the Commission implements a LAF mechanism or other similar mechanisms, a lump sum basis would be more appropriate, especially if it includes the VOIP providers (or other relevant ASPs providing voice services) because Maxis believed that currently, they do not have a proper rating engine. Maxis noted, however, that the calculation of contribution by all operators should be computed on a proportionate traffic basis (i.e. calculation of local access deficit contribution should be driven by indirect access minutes, either via EA, VOIP or the like).
- TMB agreed that from an economic viewpoint, the Commission's point that a lump-sum tax was less distortionary than a per-minute charge was a valid one. TMB also pointed out that a per-minute charge may not recover the access deficit in its entirety as the total amount would depend crucially on the volume of traffic. However, TMB noted that there were also pragmatic considerations to be taken into account in deciding on the mechanism that would best suit Malaysian conditions. A lump-sum tax would require administration by means of a fund. This

could be administratively complex to operate and there may be a significant time-delay in the creation of a new fund. In contrast, a per-minute charge would be administratively straightforward, transparent and easy to initiate. TMB noted that such a mechanism had also proven to be successful with previous charges that were collected under the Interconnection Agreements between TMB and the other operators.

- In line with previous comments, Time considered the question to be irrelevant as it was of the opinion that no contribution was needed.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the fact that 2 respondents out of the 3 material comments received prefer a per-minute mechanism. The Commission also takes note of the equally valid arguments for/against a per-minute or lump sum mechanism but still believes that the benefits of the lump sum mechanism outweigh those of the per-minute mechanism. The Commission believes that transparency could still be maintained with a lump sum mechanism.

Question 8

In principle, which types of services do you think the per minute charge should be levied on or should be taken into account when calculating licensees' contribution under a lump sum scheme?

Comments on the type of services that should be taken into account:

We summarize below the comments received on this issue:

- In line with previous comments, Celcom believes there is no need for a contribution mechanism.
- Digi was of the opinion that in principle, only fixed network operators offering equal access for long-distance and international calls should be levied on per minute basis.
- Maxis was of the view that all voice services including STD, IDD and premium services should be taken into account.
- TMB considered that in principle any services which use the fixed access network should be liable to contribute to the access deficit.
- In line with previous comments, Time considered the question to be irrelevant as it was of the opinion that no contribution was needed.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the comments received. If there is a case for the implementation of an access deficit contribution, the Commission is of the view that all services that make use of the access network should be considered for a levy. Although not mentioned by the respondents, the Commission may take into consideration the non-profitability of some services that are regulated.

Question 9

In principle, which licensees do you believe should contribute to access deficit mechanism /be liable to supplementary interconnection charges?

Comments on licensees who should contribute to access deficit:

We summarize below the comments received on this issue:

- In line with previous comments, Celcom believes there is no need for a contribution mechanism.
- Digi was of the opinion that in principle there should not be an access deficit contribution since a correctly costed and implemented universal service regime would be sufficient to compensate access carriers for any loss of revenues that they bear.
- Maxis indicated that in principle, it believed that the local access network operator's reduction in cross-subsidy revenue (e.g. from long distance and international calls) came from not only EA but also from the traffic taken up by VOIP Providers (or other similar ASPs providing voice services). Therefore, if any local access funding was required, Maxis was of the opinion that apart from PSTN operators, these voice service providers should also be required to contribute. Hence, Maxis suggested that contributions (if at all required) should come from licensees that operate/offer (i) PSTN Indirect Access services (e.g. call-by-call EA, CPS); (ii) ASPs providing voice services (e.g.VOIP services) and (iii) MVNO services.
- TMB considered that in principle all licensees using the fixed access network should be liable to make such payments. In particular, TMB considered that both indirect and equal access operators should contribute to the access deficit funding mechanisms or be liable to supplementary interconnection charges. In addition, VOIP licensees should also be subject to the access deficit funding mechanisms or be liable to supplementary

interconnection charges as VOIP services were indirect access services.

- In line with previous comments, Time considered the question to be irrelevant as it was of the opinion that no contribution was needed.

The Commission would like to thank all operators for their constructive comments. The Commission would like to make the following points:

- The Commission takes note of the comments received. If there is a case for the implementation of an access deficit contribution, the Commission is of the view that all licensees who make use of the fixed access network which gives rise to access deficit should be considered. The Commission also believes that partial of full waivers could be introduced after consideration of the existence of entry barriers and whom they benefit.

SECTION 7 : CONCLUSIONS AND RECOMMENDATIONS

7.1 This section discusses the Commission's conclusions and recommendations with regards to LAF.

7.2 The Commission takes note of the consensus in the industry for the revocation of the current LAF mechanism. The Commission will take the necessary steps to revoke the LAF mechanism.

7.3 The Commission would like to point out that due to the lack of data from TMB, the Commission has not been able to form a definitive view[5] on whether other sources of profits[6] fully allows the recovery of any access deficit.

7.4 Based on the analysis developed in the Consultation Paper and summarized in this report, the Commission is minded to consider the issue of access deficit. However, the Commission is strongly of the view that the burden of proof is on TMB (or any fixed access network provider) to demonstrate the existence of an access deficit which it cannot recover. The Commission takes note of the fact that TMB will be submitting detailed estimate of access deficit. The Commission encourages other operators to do the same.

7.5 The Commission is of the view that the alternative sources of funds as described in the Consultation Paper should be taken into account.

7.6 The Commission is of the view that, where an access deficit is calculated for funding purposes, the relevant standard is the access deficit of an efficient operator.

7.7 If there is a case for the implementation of an access deficit contribution, the Commission is of the view that:

7.7.1 the benefits of the lump sum recovery mechanism outweigh those of the per-minute recovery mechanism.

7.7.2 all services which make use of the access network should be considered for a levy (the Commission may want to take into consideration the non-profitability of some services that are regulated).

7.7.3 all licensees who make use of the fixed access network which gives rise to access deficit should be considered for a levy.

7.7.4 partial of full waivers could be introduced after consideration of the existence of entry barriers and whom they benefit.

7.8 Although the Commission would prefer to have enough elements to assess the possibility of implementing an access deficit regime before revoking the LAF mechanism, the Commission is not inclined to wait indefinitely for operators to make their points on the existence of an access deficit on their network. The

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[5] The Commission has nevertheless derived its own internal preliminary estimates based on what it believes are fair assumptions of the missing information.

[6] based on excessive profit for other line of business (excessive profit being defined as the economic profit in excess of the rate of return required by shareholders and providers of capital)

Commission will take the necessary steps to revoke the LAF mechanism, latest by 1 January 2003. This will not preclude the implementation of an access deficit contribution at a later date should the Commission decide so.