Bharti Airtel Response to TRAI's draft tariff order prescribing standard tariff package (STP) for Set Top Boxes (STBs)

The Direct to Home ('DTH') industry in India, consists of 6 private operators serving 55 million subscribers. DTH is a digital platform since its inception, therefore, customers enjoy good quality Standard Definition ('SD') and High Definition ('HD') channels along with several other features on their Customer Premises Equipment ('CPE'). DTH platform provides a national footprint to digitization of the television signal, but it is highly capital intensive . DTH operators have invested between INR 22,000-23,000 crores over the past six-seven years . Major costs for a DTH operator include satellite bandwidth, technology platform, national sales & distribution network, installation, servicing logistics, broadcasters/content fees, customer care, license fees, customs duty and high taxes. Currently, DTH is burdened by an arduous tax regime to the tune of over 35% which includes licence fee, service tax, entertainment tax and custom duty. The DTH industry presently has accumulated losses estimated at Rs. 15,000 crores.

We believe that the proposed tariff regulation prescribing a rental value for the hardware/CPE below its actual cost, threatens to put additional financial liabilities upon DTH operators impacting their margins while impeding their growth. The DTH industry cannot afford to absorb any further costs or incur further losses. In addition to the estimated losses of Rs 15,000 crores, implementation of this draft tariff order will result in a further losses of more than Rs 2,500 crores**. Further, digitisation itself will come to a halt ,defeating the Government objective of implementing digitization in the Country**.

The explanatory memorandum states, that the proposed tariff order will protect the consumer interest through the provision of commercial interoperability. However, commercial interoperability already exists in the form of hire-purchase, outright purchase and rental schemes for CPE being provided by DTH operators where the customer has a free choice to return the CPE and move to another operator. We believe that regulating CPE rental value is not the right way of ensuring commercial interoperability and any imposition of these rental models would further impede the growth of DTH services in the Country.

It is important to highlight that the DTH industry subsidizes CPEs in the range of Rs. 2,200 and Rs. 2,700/- to make them affordable for customers. This subsidy is a substantial cost on DTH industry adding to the accumulated losses mentioned above each year.

TRAI in its draft tariff order has assumed a value of Rs. 2,250/- per CPE, whereas the actual cost of CPE is in the range of Rs. 4,000 to Rs. 5,000 per acquisition which is more than twice the assumed cost. Considering, the current rate of gross additions at 10 million per annum the loss to the industry on account of such a low CPE cost proposed, may be approximately Rs 2,500 crores.

The **four rental options** proposed by TRAI will further impact costs of DTH operators since, there is no option/means provided to recover the actual / full cost of CPE, in case of a new activation or churn. Moreover, there are additional costs for installation, delivery, repairs & maintenance, taxes, customs duty and license fee for all CPEs which have not been accounted for in TRAI's cost assumptions. As per our estimates the loss to Airtel over a period of 5 years , in implementing the proposed rental plans will be more than Rs. 1000 crore. This is over and above the subsidy already given on CPE's at Rs. 2,600/- per subscriber addition. Further, TRAI has restricted charging an upfront amount for a new activation in the proposed tariff order and has considered a security deposit of mere Rs. 500/- and Rs. 1,000/- , insufficient to securitise the actual cost of CPE/Hardware. Considering, the DTH industry churn rate of around 14-15% the proposed Rental plans will make the loss, for new activations, permanent on DTH operators.

In view of the above we humbly request the authority not to prescribe any rental ceilings for DTH CPE. However, if at all this tariff order is to be implemented then **we urge the Authority to recommend to Ministry of Information and Broadcasting to setup a mechanism to compensate the DTH industry for the losses incurred on account of CPEs to be provided mandatorily at a value less than its actual cost.** We also request that this tariff order should be implemented post release of compensation package for the DTH industry.

The detailed comments on the Draft Tariff order prescribing rental plan for STB are as follows:

A. Tariff for CPE

1. Subsidy for CPE:

- As per the current market dynamics the CPEs are already provided at a subsidized rate to customers. DTH operators offer these CPEs between Rs. 1,600 and Rs. 2,200/-. The subsidy on CPE is in the range of Rs. 2,200 and Rs. 2,700/- across all DTH operators.
- Airtel provides its CPE at a rate of Rs. 1,700 approximately *(excl. taxes)* and at a subsidy of around Rs. 2,600 - per CPE. This needs to be recovered over a period of subscription of DTH services by the customer.
- The industry adds approximately 2.46 Million subscribers every quarter. With 10 million gross additions per annum the loss to the industry on account of non-recovery of CPE subsidy may be an estimated Rs 2,500 Crores.
- Any churn in the short run is an additional loss to a DTH operator on account of the subsidy.
- As mentioned above, the CPEs are already being subsidized by the DTH operators. However, any tariff regulation such as ceiling rental on CPEs, without providing other avenue for recovery of such costs, will result in permanent losses for DTH operators.
- The proposed tariff order will also adversely affect an operators' ability to introduce innovative tariff plans to cater to the need of various consumer segments and have a negative impact on the growth of this sector.

2. Tariff Regulation on CPE Hardware is unprecedented:

The draft tariff order proposes to mandate a standard rental package for the sale of the CPE. In this regard, it is submitted that:

- A tariff regulation involving regulating prices for CPE / hardware is unprecedented.

- Competition in DTH services (6 operators) is adequate to keep entry/activation costs low for subscribers.
- In the telecommunications sector, purchase of handset is the responsibility of the subscriber. TRAI has never delved into regulating tariffs for such handsets even in the case of CDMA services, where the handsets were network locked.
- DTH operators are completely dependent on CPE manufacturers, custom duties, CVD, taxes, levies, technology used, foreign exchange fluctuations that drive the prices for such CPEs, with no ability to control these prices. There is no government regulation on CPE manufacturer's to control their prices and hence DTH operators may not be able to ensure compliance to a regulated tariff for such a CPE.
- Hardware/CPE is not a revenue stream for DTH operators; in fact it is an entry cost which DTH operators have been subsidizing for its customers. It is pertinent to also mention that the primary business of a DTH operator is to distribute broadcasting signals using the DTH platform. CPE is the hardware to access services offered by a DTH operator. CPE/Hardware provisioning is incidental and not a DTH service hence; their prices may not be regulated.

We humbly submit that imposing a tariff ceiling on DTH operators by way of rentals would hamper the very sustainability of DTH operators. **Any regulated rental values of CPE would stifle the growth of DTH services and adversely impact DTH operators by imposing higher costs.**

3. **Comments on TRAI's cost calculation of CPE to determine rental value/plan:**

- TRAI has computed the rental model on an assumed total cost of Rs 2250 for the CPE. It has further proposed to disallow any charging for activation, repair and maintenance for a period of 5 years.

- The current cost of DTH CPE is much higher than the assumed cost above. Further the DTH CPE includes a set top box, dish antenna, LNB, wires, connectors, viewing cards and a remote control etc. It is quite evident that the authority has not included all the cost while arriving to Rs. 2250/-.

- Further, the costs of custom duties, entertainment taxes, license fee, transportation, installation, call centre, repair and maintenance etc. have not been considered by TRAI.

- An activation of DTH services involves a much higher cost which is approx Rs 4000-Rs 5000 as compared to Rs. 2250/- proposed by TRAI.

- **Moreover, the cost of CPE varies with the Technology used e.g. MPEG- 4/DVBS2 CPE is costlier than the MPEG- 2/DVBS CPE however the authority has proposed a common price.**

- Any rental model should include all costs for CPE which include the one time activation fee and the additional recurring costs for maintenance of the CPE.

- We would further like to highlight the actual landed cost of CPE incurred by the DTH operator, subsidy provided to each customer and the impact of imposing the TRAI draft tariff order is as follows:

SD – STB	UOM	Mar-13
SD STB Cost (Including remote & adapter)	USD	36
ODU Cost	USD	11
Applicable duties (Net of CVD)	%	24%
CPE Cost (Including duties) (A)	Rs	3,159
Other charges including acquisition cost, Installation charges & Freight	Rs.	1,100
Total Landed cost for *CPE* (A+B) = C	**Rs.**	**4,259**
Charge per customer (Net of service tax) (D)	**Rs.**	**1,672**
Subsidy per customer (C-D)	**Rs.**	**2,587**
CPE price assumed by TRAI (Excl of service tax) E	Rs.	2,250
Loss per customer at TRAI Price (C-E)	**Rs.**	**2,009**

It can be easily interpreted from the table above that:
Airtel will have to subsidize each customer with at least Rs. 2600/- if TRAI's proposal based on the CPE cost of Rs. 2250/- is implemented. There are 2-2.5 million additions expected in a year by Airtel.

- Apart from the first time activation loss, the draft tariff order proposes a restriction to recover the recurring charges which are shown in the table below:

SD STB	Unit
Repair and maintenance charges	Rs 125- Rs 150 per visit
Installation charges	Rs 350 per visit
Remote replacement charges	Rs 350 per unit

The above table shows the recurring costs for each CPE. The proposed tariff order restricts operators to recover these costs from CPEs. In case, these costs are unrecoverable it would dis-incentivise the DTH industry.

- Additionally, the **DTH industry works on a prepaid subscription model and has a churn rate of around 14-15% per annum,** therefore imposing any rental plan with a much lower security deposit of Rs 500 or Rs 1000 will lead to increase in customer defaults in returning the CPE.

3(a). Unlimited Repair and Maintenance:

The draft tariff order restricts an operator to recover any charges for repairs and maintenance of the CPE for a period of 5 years. We would appreciate if the same were allowed to be recovered from customers and the rationale is as below:

- Repairs and maintenance is an on-going activity. 5 years free repair and maintenance / AMC for the CPE would force out of pocket expenses for DTH operators since this translates to unlimited on-site visits for fault repair, maintenance etc. which are out of the control of an operator.
- Damages can be caused to the CPE due to voltage fluctuation/electrical failure, environment & climate reasons like rains, thunder storms and lightning. All such damages would require engineer visits.
- Remotes are purely handled by customers with a high degree of user related fault such as mishandling, wear and tear etc. DTH operators will be required to absorb the replacement cost along with an on-site visit costs. Therefore, such a cost cannot be included in the warranty/AMC/CPE rental.
- DTH operators incur about Rs 125/- to Rs. 150/- per customer for an on-site visit to repair and maintain the CPE.
- Apart from this each repair, maintenance or installation the calls received by an operator at the call centre imposes a further cost of Rs. 14/- per minute.
- All these costs are prone to inflation.
- The operators should be allowed to charge for repair and maintenance charges to discourage misuse of the facility.
- The regulation should transparently recognise that such costs exist and should allow the recovery of these costs.

This restriction would result in an annual loss of Rs. 50 crores. We would like to submit that the repairs and maintenance of CPE has a definitive and substantial cost, hence, cannot undertaken free of cost.

3(b). Installation costs:

- DTH operators incur a cost of around Rs 350 per on-site CPE installation being paid to a third party.
- Installation has to be managed on a pan-India basis and therefore requires a call centre to manage the logistics of on-site installations between the retailers, third party installers and the customer premises.
- The subscriber churn is high and any restriction on recovery of installation and re-installation costs would be an additional burden on DTH operators who are already burdened with the subsidy provided for each CPE.

3(c). Cost of Refurbishment of returned CPEs:

- The current churn rate is high as 15%.

- All returned STBs, if at all they are returned by the churned subscriber, would require the CPE including the STB and Remote Unit to be refurbished and re-packaged before being provided to a new customer even on the rental basis.
- The minimum cost of this refurbishment is Rs. 1,000/-. This alone would impose a cost of Rs. 135 Crores per annum for refurbishment to a DTH operator.
- Further the CPEs not returned would lead to a direct loss of CPE value for the DTH operators.

3(d). <u>Foreign Exchange Fluctuations</u>

The prices or manufacturing cost of CPE vary depending on the technology used and are also dependent on extraneous factors such as exchange rate of the rupee etc**.** In fact, in the past one year alone foreign fluctuations have led to the depreciation of the Indian Rupee by almost 22% directly impacting the cost of all imports. Hence, a tariff regulation on the rental value of a STB and that too at such a low value threatens to put cost liabilities upon DTH operators impacting their service margins entirely

3(e). <u>Taxes and Levies</u>

- DTH is already burdened by an arduous tax regime to the tune of over 35% including Licence Fee, service tax, entertainment tax and duty on imports to the custom department .
- The import duty on set top boxes too has increased from 5% to 10 %.
- The license fee is 10% on the Gross Revenue of a DTH operator. Any sales proceeds, rental income from CPE are accounted for in the gross revenue for a license fee to be paid.
- The draft tariff order would be a further burden on this industry which is incurring losses on account of a subsidised CPE as mentioned earlier in our response.
- We would also like to urge the Authority that in order to promote/incentivize digitization in the country, it should take a strong initiative to facilitate cutting down of **custom /excise duties, license fee and other taxes on import & manufacturing of STBs.**

To summarize, we believe that the prices for CPE should not be regulated since these are already been subsidized heavily by the operators and it **should continued to be decided by the market forces.**

4 <u>Estimated Loss to a DTH provider in implementing the TRAI's Proposal:</u>

Assuming;

- The subscriber base will get 2 Million gross additions per Annum.
- Churn rate of 4% in first year to 17% in third year and 15% in the final year.
- Assuming current CPE cost of Rs 3200 including applicable duties and total landed cost of Rs 4300 including installation, freight, third party commission etc.
- The operator would suffer a loss of more than Rs. 1000/- crores.

We shall be sharing the calculation of the above estimated loss separately.

5 **Churn and Securitization of CPE Costs**

- **No protection against defaults:**
  - The draft tariff order does not propose any measure for protection to a DTH operator in case a customer defaults before paying off all the installments or rental value for the CPE.
  - There are customers who do not recharge their STBs each month and therefore the recovery of rentals is not possible in those cases. Moreover**, repossession of assets/CPEs from defaulting customers is almost impossible and is only around 2-3% of the monthly churn for us. Therefore, the entire loss in case of a defaulting subscriber will be to the DTH operator's account.**
  - The DTH industry works on a prepaid subscription model and has a churn rate of around 14-15% per annum, therefore imposing any rental plan with lower security deposit of Rs 500 or Rs 1000 may lead to increase in customer defaults in returning the CPE.
  - The recovered box has only scrap value as majority of customers do not accept a second hand set top boxes and CPE for DTH services. This it has to be refurbished before providing to a new customer.
  - STB is required to be refurbished before it can be deployed at any other premise. The cost of refurbishment has not been taken into account.

- **Proposed security deposit is far lower than the actual cost of CPE:**
  - In all the four rental options that have been proposed by TRAI, the proposed security deposit is much lower than the actual cost of service provider.
  - The security deposit of Rs. 500/- or Rs. 1,000/- does not propose to cover the risk of customer not recharging, not paying or not returning the CPE.
  - The low security deposit mandated by way of a tariff regulation would render a DTH operator unable to protect their investments in CPE from risk - fraud or theft.

6. Stifling Innovation

- Fixing of a rental value of CPE dis-incentivises DTH operators to offer any innovative features or services to customers.
- There are DTH operators today who offer common remote control features (for TV and STB combined) may not be able to provide that in the same price.
- The DTH operator would be forced to withdraw some features such as recording facility in SD STB since the current costs taken by TRAI does not include the cost of such technological innovation or facilities added in these CPEs.
- The operators will have not motivation to upgrade or add features in the STBs.

Any tariff regulation on hardware/CPE would stifle innovation in CPE and force the DTH operators to withdraw all innovative products.

In view of the above we would humbly request the authority not to prescribe any rental ceilings for DTH CPE.

B. Reporting Requirement

1. Clause 4: New Tariff package reporting requirement: 7 days prior to the launch of the product:

TRAI's proposal to reduce the time frame for Pre- launch tariff reporting to 7 days from 30 days is laudable. We would appreciate it if TRAI may consider amending the reporting requirement to **7 working days post a launch/change in tariff plans**. The rationale is as below:

- The existing Telecommunication (B&C) services (fourth) (addressable systems) Tariff order, 2010 dated 21 July 2010, requires that any change in tariff packages are to be reported to TRAI 30 days prior to the launch of a plan. This not only endangers the confidentially and competitive advantage of an operator but delay time for an operator to offer dynamic tariffs in the market to suit the needs to various subscribers. Also it has stifled the ability of operators to respond to competitive offers and a rightful chance to retain their subscribers in line with offers available in the market place.

- The present DTH market is very dynamic. Each DTH operator should have the flexibility of matching tariffs or changes thereof introduced by competition to retain their rate of acquisition and existing subscribers e.g., Operator A introduces a rate cutter in any pack, operator B should be allowed to respond with a similar rate cut in the market within 24 hours to allow him to maintain his market share.

- In the Telecommunications sector the Authority requires tariffs to be reported within 7 days of launch of any tariff plan or voucher or special tariff vide the 30th amendment to TTO '99. This has been an established practice since the year 2004 and has served as the edifice for a robust competitive growth in telecom services witnessed over the last decade. **A similar practice may kindly be adopted in the broadcasting sector, particularly DTH services as well allowing for the services to grow at a faster pace.**

There are 6 private operators in the DTH space and additionally the digitization has brought cable operators on a similar and at a slightly more advantageous spot which has infused high competition for DTH operators. The market conduct is relatively mature for services to start offering dynamic tariffs and for competitive inter play **we therefore request the Authority to continue the policy of forbearance in DTH CPE charges.**