



Submission to Bureau of Communications  
Research

NBN non-commercial services funding options

June 2015

## Section 1. Introduction

- 1.1 This submission responds to the Consultation Paper released by the Bureau of Communications Research (BCR) on the NBN non-commercial services funding options.
- 1.2 In principle Optus supports the need for more transparent and competitively neutral funding arrangements to fund the losses likely to be incurred by NBN Co in providing high-speed fixed broadband services in non-commercial areas. In particular, it would be useful to identify and estimate the extent of the forecast losses so that there is transparency of the current subsidy embedded within NBN Co's uniform wholesale access prices.
- 1.3 However, whilst the losses should be identified Optus questions whether this is the appropriate time to implement new funding arrangements;
  - (a) The NBN rollout is still at an early stage and will not be completed for many years;
  - (b) The major alternate networks are being closed down and customers are being migrated to the NBN;
  - (c) Whilst some RSPs have announced the roll-out of alternate high speed broadband networks the extent of competition these will apply to NBN Co is not clear; and
  - (d) Any calculation of forecasts losses are almost certain to change given the extended time period over which such losses will need to be measured, which means that any levy amount will need to be changed.
- 1.4 To avoid an unnecessary red-tape burden on industry Optus recommends that any alternate funding arrangements are only implemented once a threshold number of non-NBN Co fixed high-speed broadband SIOs has been reached.
- 1.5 In terms of measuring any losses related to the provision of non-commercial services Optus recommends the following approach;
  - (a) Losses should be measured having regard to the direct costs to provide loss making services together with an appropriate share of common costs;
  - (b) Any modelling of costs should be consistent with the method, assumptions and inputs used in the modelling in the NBN Co SAU;
  - (c) Any funding should be based on a contribution across all qualifying wholesale fixed line high-speed broadband lines (NBN and non-NBN networks). This should not include corporate fibre networks or mobile services.
  - (d) Any charge should be levied on a transparent basis to owners of high-speed broadband networks based on their share of total high-speed broadband lines (NBN and non-NBN). In practical terms this should be levied as a dollar amount per SIO. The amount should be charged transparently through the Commonwealth and would apply equally to NBN and non-NBN wholesale fixed line services<sup>1</sup>. To avoid double cost recovery NBN Co's access charges will need to be reduced by the amount of the levy.
- 1.6 The objective of funding should be to ensure that services provided over non-NBN high-speed broadband wholesale networks contribute to the provision of non-economic services by NBN, i.e. they provide NBN with the cross-subsidy contribution it would

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<sup>1</sup> For clarity this would also include self-supplied wholesale services.

otherwise have recouped from servicing customers that might now be serviced by an alternate wholesale fixed line broadband network.

## Section 2. Limited justification for action

- 2.1 NBN Co's approach to pricing of services is currently based on a uniform national average basis; with the same prices applying for services across Australia. To the extent that certain NBN services are considered to be non-commercial or loss making, then the losses resulting from the provision of those services is effectively funded through a cross subsidy on all other services. In practical terms it is anticipated that metropolitan users of fibre based NBN products will subsidise the services provided to end-users over NBN Co's fixed wireless and satellite services.
- 2.2 The Vertigan Review has raised concerns with the use of this internal cross-subsidy mechanism by NBN Co in its access pricing arrangements. In particular, it has concluded that the arrangements:
  - (a) Lack transparency;
  - (b) Do not support contestability; and
  - (c) That they are not competitively neutral with the risk that the subsidy could be eroded over time if NBN Co faces competition from new entrants in commercial areas.
- 2.3 In response to the Vertigan recommendations the Government is seeking to implement more transparent and competitively neutral funding arrangements that will apply to services provided over all high speed broadband networks. This is the basis for the current Discussion Paper by the BCR.
- 2.4 In principle, Optus agrees that the current cross-subsidy arrangements are not ideal and that a more transparent and competitively neutral approach is required. Optus believes that the inherent cross-subsidy should be identified on a per SIO basis and if NBN Co faces competition from other wholesale fixed high-speed broadband networks then a levy should be applied on an equivalent basis to all services supplied over those alternate networks.
- 2.5 However, there are some important practical issues to be addressed in implementing these arrangements. Estimating the losses with any level of accuracy will not be a straight forward task. NBN Co's current access prices are based on forecast NBN Co's costs and revenues over a thirty year period. The losses for the services will similarly have to be assessed over a long-period, which means the accuracy of the calculation will be uncertain. Any levy amount will need to be reviewed periodically to ensure that it remains in line with the latest revenue and cost forecasts, which will inevitably change over time.
- 2.6 More importantly, the need for alternate funding arrangements is based the assumption that NBN Co will face competition in commercial areas and absent such funding it will not be able to cross subsidise its losses. At the current time the competitive threat to NBN Co is speculative. Whilst Optus understands that at least one RSP has announced that it will roll-out alternate services to NBN, it remains unclear how significant an impact this will have on NBN Co's forecast footprint.

- 2.7 There is a risk that a considerable amount of work and cost is devoted to developing an industry-wide levy mechanism to recoup a negligible amount of cross-subsidy leakage. To limit the red-tape costs on industry Optus recommends that whilst it would be useful to identify the losses associated with non-commercial services the implementation of an industry funding mechanism should only proceed once a threshold level of competing services has been triggered.

## Section 3. Response to specific questions raised

### Cost measurement

**Question 1** *Is measuring NBN satellite and fixed wireless service costs on a commercially focused basis appropriate?*

**Question 2** *Is it appropriate to consider commerciality on a network 'cluster' basis?*

**Question 3** *Is FY2040 at an appropriate time period for assessing NBN non-commercial services?*

- 3.1 Issues of cost measurement will be determined by the objective of the funding proposal. As noted above Optus considers that the objective of any funding proposal should be limited to ensuring only that all fixed high-speed broadband services provided in commercial areas contribute to the losses incurred in providing fixed high-speed broadband services in non-commercial areas on an equal basis. The funding mechanism should aim to achieve no more than this objective.
- 3.2 Given this, Optus agrees with the recommendation in the discussion paper that the losses should be measured having regard to the direct costs of providing services on the fixed wireless and satellite areas together with the an appropriate contribution to common costs. Neither of the alternate approaches such as stand-alone costs or marginal costs canvassed in the discussion paper appears relevant as they would not represent likely actual losses face by NBN Co in the provision of the relevant services. Each of the alternative approaches would be relevant if funding was to promote different objectives; such as contestability in the provisions of services.
- 3.3 Further, in measuring costs it is important to apply as much precision as possible. For this reason Optus supports an approach which identifies the profitability of fixed wireless services on a cluster basis. To the extent that there are profitable fixed wireless areas then services provided in these areas should contribute to any losses of non-commercial services.
- 3.4 It is appropriate to assess NBN Co's non-commercial services over an extended time period given the length of the rollout and the likelihood that it will take many years for NBN Co to become cash flow positive. Optus supports the proposal to align the assessment of the losses for non-commercial services with NBN Co's SAU, i.e. up to FY 2040.

### Principles

**Question 4** *Are the proposed principles relevant and applicable for considering NBN non-commercial service funding arrangements?*

**Question 5** *Should the BCR consider additional principles? If so, what are they?*

**Question 6** *To what extent could financial reporting support transparency of the allocation of equity, debt and revenues towards non-commercial services?*

- Question 7** *What issues are associated with maximising economic efficiency in developing NBN non-commercial service funding arrangements?*
- Question 8** *In designing NBN non-commercial services, how can pro-competitive market conditions for the provision of both non-commercial and commercial services best be achieved?*
- Question 9** *What issues are associated with developing sustainable NBN non-commercial service funding arrangements?*
- Question 10** *What equity issues need to be considered as a result of NBN non-commercial service funding arrangements?*
- Question 11** *What are appropriate mechanisms and measures to ensure equitable outcomes?*

- 3.5 Whilst Optus believes it is useful to adopt a set of principles to help guide the development of a funding mechanism it is also necessary to set out an overall objective of such a funding mechanism. Without such an objective it will be difficult to determine whether a funding mechanism is fit for purpose regardless of whether it adheres to the proposed principles.
- 3.6 Optus believes that the objective of any funding mechanism should be to ensure that all fixed high-speed broadband services in commercial areas contribute to the losses in non-commercial areas on an equitable basis. This will ensure that the same dollar value subsidy is applied to services offered on the NBN or non-NBN fixed high-speed broadband networks. This would be the optimal way to address the policy problem of non-NBN fixed high-speed broadband providers being able to supply services at a lower cost than NBN due to not having services in non-commercial areas.
- 3.7 Given this objective Optus believes that the principles outlined in the discussion paper relating to transparency, economic efficiency, sustainability and equity are reasonable. However, Optus remains to be convinced about the efficacy of setting “contestability” as a principle. By definition the services for which subsidy arrangements are being developed are non-commercial so it is unrealistic to expect there to be interest from alternate providers, especially given the very large costs that will be sunk to provide the NBN fixed wireless and satellite services. The non-contestability of a national high-speed broadband network is one of the reasons for the existence of the government owned NBN Co.

### **Financial model**

- Question 12** *Is a discounted cash flow methodology based on NBN Corporate Plan projections an appropriate approach to modelling NBN non-commercial service losses? If not, why not?*

- 3.8 A key input variable in determining the extent of the losses for NBN Co’s non-commercial services will be the revenue that NBN Co can charge RSPs in respect of those services, These access prices will be determined by the SAU which itself is based on an asset building block approach rather than a discounted cash flow approach.

- 3.9 Whilst Optus understands that a discounted cash flow analysis is simpler and is therefore the preferred approach of the BCR we do not believe such an approach is appropriate. Under the current wholesale pricing arrangements access charges are set on a uniform national basis. Total forecast costs are divided by total forecast services. Therefore, charges implicitly include the value of any losses for non-commercial services. To avoid double recovery of costs, NBN Co's access charges will need to be adjusted to reflect any separate levy applied. It will be important, therefore, to ensure that the losses for non-commercial services are calculated on a consistent basis with NBN Co's access charges.
- 3.10 It is also important to ensure consistency between the two regimes. The Building Block Methodology (BBM) in the SAU is used to set the regulated prices of NBN Co. The regulated price takes into account the cost to operate the national network. The BBM has the implicit cross subsidy built into it. The losses in the roll-out phase are allowed to be 'banked' and recovered through above-cost prices in later period. It is only after the end of the cost-recovery period that the SAU imposes a cost-based regulation obligation on NBN Co. Any change to the approach of cross subsidies must be reflected in changes to the SAU modelling – and hence may change the price regulation of NBN Co.
- 3.11 For this reason Optus recommends that a building block approach is used to measure the losses. In practical terms this calculation should be done within the scope of the NBN Co SAU modelling.

**Question 13** *What, if any, issues arise in using NBN Co Corporate Plan financial estimates for the purpose of assessing NBN non-commercial service losses?*

- 3.12 In a project of the scale of the NBN there is inherent uncertainty in any of its financial projections. The initial financial projections have already been subject to substantial revision, particularly following the Strategic Review undertaken at the request of the current Government. It is almost inevitable that further adjustments will be made to revenue and cost projections over the next 30 years.
- 3.13 At this stage of the project it will be almost impossible to measure losses associated non-commercial services with any level of accuracy at this stage in the roll-out. Consistent with Optus' comments above the rationale for undertaking this exercise at this stage of the roll-out and in the absence of any real evidence that NBN Co is being impacted by competitive entry in metropolitan areas is questionable.
- 3.14 Nevertheless, to the extent that losses are to be calculated, then consistent with our comments above Optus recommends modelling should use consistent inputs to the NBN Co SAU. There are arrangements under the SAU for cost and revenue assumptions to be adjusted over time as more accurate information becomes available based on actual experience to date.

**Question 14** *Is a fully allocated cost approach appropriate for the treatment of NBN non-commercial services? What are the strengths and limitations of this approach?*

- 3.15 Optus supports the use of a fully allocated cost approach. It will, however, be important for the model to identify appropriate drivers for the allocation of common costs.



**Question 15** *What are the relevant issues in determining a discount rate for NBN non-commercial services?*

**Question 16** *What discount rate should be considered for NBN non-commercial services?*

- 3.16 Optus recommends that the discount rate to be applied should be the same as that used in the SAU, which has been assessed and approved by the ACCC. There is no justification to use a different discount rate.

**Question 17** *What issues arise when considering the application of a terminal value for calculating NBN non-commercial services?*

- 3.17 Optus does not support application of a terminal value to the calculation of losses unless this is deemed to be a positive contribution. Any calculation of such a valuation would be speculative in the extreme. Further, any approach which increases the value of the losses would amount to an inter-generational cost transfer from future to current users of broadband services.
- 3.18 Further, given the time period over which an assessment of losses is to be calculated the terminal value is likely to have little impact once the discount rate is applied.

**Question 18** *What are the key sensitivities or scenarios which should be considered?*

- 3.19 There will be a number of key sensitivities to be factored into any analysis given the long time period over which these losses are to be valued. A critical factor that is central to the utility of the analysis is the extent of competition NBN Co is likely to face from alternate high speed broadband providers. To avoid unnecessary red-tape it would be useful to set a threshold of a number of competing SIOs which would need to be reached before this analysis is undertaken.

### **Funding arrangements**

**Question 19** *Should NBN Co contributions towards NBN non-commercial services, and funding to deploy and maintain these services, be made via a Commonwealth account?*

**Question 20** *What issues should be considered when examining industry funding eligibility?*

**Question 21** *Is it reasonable to apply a service standard to determine eligibility? If so, is a high-speed broadband speed criteria based on a minimum download speed of 25 Mbps reasonable?*

- 3.20 As indicated in the sections above, Optus considers that funding of any potential losses should be calculated and applied on a per SIO basis in respect of high speed broadband services offered over both the NBN and non-NBN wholesale fixed high-speed networks. This will achieve the primary objective of ensuring equity in the funding of such losses.

- 3.21 To facilitate this arrangement it would be preferable for any levy to be established and applied through a Commonwealth administered fund. The levy contribution should be applied to all fixed high-speed broadband services supplied over eligible wholesale networks. From a practical perspective the levy should be applied from the Commonwealth to the owners of the wholesale networks over which those services are supplied<sup>2</sup>.
- 3.22 In terms of qualifying services, Optus believes it will be necessary to determine the eligibility of alternate wholesale fixed line high speed broadband networks. This ought to be based the definitions of superfast services specified in the Competition and Consumer Act and the Telecommunications Act.

**Question 22** *In the context of NBN non-commercial services, what issues should be considered regarding eligible revenue or other eligibility thresholds?*

**Question 23** *To what extent is it appropriate to consider proportionality when developing funding arrangements?*

- 3.23 As indicated above, to limit the re-tape costs on industry Optus recommends that whilst it would be useful to identify the losses associated with non-commercial services the implementation of an industry funding mechanism should only proceed once a threshold level of competing services has been triggered.

**Question 24** *It is practical to consider contestability in the provision of NBN non-commercial services?*

- 3.24 The fact that the services are loss-making and NBN Co will have sunk substantial costs to provide these services it is highly unlikely that NBN will face competition for the delivery of non-commercial services. Accordingly, the BCR should not be distracted by concerns about contestability arrangements when designing the funding arrangements.
- 3.25 It is clear from the operation of 'contestable' USO areas in the current regime that non-commercial regional services are not contestable.

**Question 25** *Would bill transparency arrangements be beneficial?*

**Question 26** *Is it feasible for NBN non-commercial services to be reflected on end user invoicing?*

- 3.26 As indicated above the levy should be applied to owners of wholesale fixed high-speed broadband networks. It is likely that these charges will be passed on to RSPs in wholesale access fees. How the charge is passed on should be determined by the wholesale access provider.

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<sup>2</sup> A levy applied to NBN Co should be separately accounted from access pricing (note that the current NBN Co access pricing includes this cross subsidy, so imposition of a levy would reduce the access price so that the new access price plus levy equals the old access price). Similarly, an owner of an alternative wholesale high-speed broadband network is likely to add the levy on top of the access charge.

**Question 27** *Is there opportunity to amend the existing USO collection arrangements to include NBN non-commercial services collection arrangements – noting that industry funding eligibility may be different?*

- 3.27 Optus does not support combining the NBN non-commercial service arrangements with the USO unless and until the USO levy arrangements are reformed. The USO levy is applied on the basis of licenced carrier's eligible revenue, whereas the non-commercial levy should be applied to the owners of wholesale fixed line high-speed broadband networks based each networks share of high-speed broadband SIOs.

**Question 28** *To what extent will elements of the SAU need to change to accommodate the introduction of NBN non-commercial service funding arrangements?*

- 3.28 It is the outputs from the SAU that will need to be adjusted rather than the inputs or other elements of the SAU.
- 3.29 Under the current wholesale pricing arrangements access charges are set on a uniform national basis. Total forecast costs are divided by total forecast high speed broadband services. Therefore, charges implicitly include the value of any losses for non-commercial services. To avoid double recovery of costs, NBN Co's access charges will need to be adjusted to reflect any separate levy applied.