Supplementary Submission in response to Bureau of Communications Research Discussion Paper

NBN non-commercial services funding options

PUBLIC VERSION

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CONTENTS

Section 1. EXECUTIVE SUMMARY

1.1 Optus' wishes to provide an additional submission addressing comments in NBN Co's submission to the Bureau of Communications Research (BCR) consultation paper on NBN non-commercial serviced funding options.

1.2 NBN Co submits that any industry levy should include providers of wireless as these are close substitute services to the NBN. NBN Co argues this will aid economic efficiency and equity and reduce uneconomic distortions to competition.[1]

1.3 Optus finds that such a statement is flawed as it is inconsistent with:

(a) The Government policy statement for the levy;

(b) Natural monopoly claims of NBN Co;

(c) Non-contestability claims for NBN Co's wireless network; and

(d) The objective of not increasing prices to consumers.

1.4 There is merit in ensuring that alternative owners of alternate fixed high-speed broadband services in metro areas contribute to the rural cross-subsidy inherent in NBN Co's pricing. Optus supports this approach. This is because the natural monopoly characteristics of fixed line broadband means that only one fixed line network can service a premise. For instance, there is likely to be only one provider of VDSL FTTB services in each multi-dwelling unit (MDU). The presence of non-NBN Co networks precludes NBN Co from having an opportunity to gain the consumer.

1.5 But this justification has no relevance to the interaction between mobile broadband and the NBN. The deployment of mobile broadband does not deprive NBN Co from an opportunity to obtain services from an end-user. NBN Co will be able to attract end-users if it can offer better services at a lower price than wireless networks. There is no natural monopoly if fixed and mobile broadband are in the same market.

1.6 Moreover, wireless networks are national networks and cannot be considered cherry-picking metro customers. Mobile networks face the same internal cross-subsidy that any national network faces. Mobile networks cover much of the same landmass as NBN Co (and were deployed prior to the roll-out of the NBN). Should mobile networks have a cost advantage to NBN Co, this would not arise because they are avoiding high-cost areas; it will be because they are operating more efficiently and face market discipline.

1.7 Imposing a tax on wireless broadband will do nothing to discourage cherry-picking of the NBN. But it will result in higher prices for consumers of both wireless services and NBN services.

1.8 Ultimately, it is difficult to avoid the conclusion that NBN Co's proposal is not one aimed at ensuring a level playing field between it and owners of alternate fixed line broadband networks (the objective of the BCR review), rather it is aimed at shifting costs away from users of the NBN to users of mobile networks and to plug potential gaps in NBN Co's financial projections.

[1] NBN Co, Submission to discussion paper, p.17

Section 2. POLICY REASONS FOR INQUIRY

2.1 It is important for this Inquiry to remain mindful of the policy reasons leading to the Government's position to identify the cross-subsidy inherent in NBN Co's current wholesale access pricing.

2.2 The Vertigan review of the NBN recommended that the provisions that prevent owners of alternate fixed superfast networks from entering the retail market should be altered. The Vertigan Report highlighted that the purpose of the statutory protections preventing entry was to prevent alternative vertically integrated superfast network providers from advantaging themselves over independent RSPs and from undermining NBN Co's ability to cross-subsidise its rural network.[2]

2.3 Vertigan questioned the merits of a broad restriction on entry. In relation to the ability of NBN Co to fund its rural service obligations, Vertigan recommended this should be "*done through arrangements that are transparent and accountable, rather than by means of opaque restrictions on competition*."[3]

2.4 The discussion in the Vertigan review centred on NBN Co and new alternative high speed fixed access networks, it did not relate to wireless networks. It is also instructive to note that NBN Co agreed with the fixed-line focus of cherry-picking concerns:

> *Given the* **natural monopoly characteristics inherent in fixed telecommunications** *infrastructure, any duplication of fixed network costs will raise the overall cost of delivering broadband services thereby reducing overall industry profits. Consequently, over time an incremental cost approach will mean that the burden of funding the provision of non-commercial fixed wireless and satellite services will represent an increasing share of industry profits – such an outcome is unsustainable and will not maximise overall social welfare.*[4] [**emphasis added**]

2.5 It is in this context that the Australian Government responded to the Vertigan recommendations and tasked the BCR to "*provide options to Government for replacing the current opaque NBN Co cross-subsidy* **embedded in its wholesale access prices** *with more transparent funding arrangements*."[5] The Australian Government continued to state that the cross-subsidy will be replaced with:

> *… transparent funding provided via contributions* **sourced from owners of high-speed broadband access networks** *that target residential and small business customers – i.e. the NBN and networks in commercially viable areas that are comparable to the NBN. There will be* **no additional costs to consumers** *relative to current NBN pricing – an opaque part of the cost of the NBN will be made explicit. The Government will provide the ACCC with sufficient powers to monitor the introduction of these arrangements.*[6] [emphasis added]

2.6 There are two key points:

(a) Contributions sourced from <u>owners</u> of high-speed broadband <u>access</u> networks; and

[2] Vertigan Report to Government; NBN Market and Regulatory report, p.76

[3] Vertigan Report to Government; NBN Market and Regulatory report, p.77

[4] NBN Co, Submission to discussion paper, p.6

[5] Australian Government, 2014, Telecommunications Regulatory and Structural Reform, December, Section 2.6

[6] Australian Government, 2014, Telecommunications Regulatory and Structural Reform, December, Section 2.6

(b) No additional costs to consumers.

2.7 These two requirements go together – the aim of this process is to break down the total cost of NBN Co access charge into a metro cost and a cross subsidy element. The cross-subsidy amount would then be 'charged' to alternate high-speed broadband access networks to ensure parity in metro areas. This is to ensure that every superfast access line in metro areas contributes to the rural cross-subsidy.

2.8 Optus reiterates that the 'superfast network rules' never applied to wireless networks. Therefore, rules designed to mimic the cross-subsidy impact of these rules should also have no application to wireless networks. It is unreasonable for NBN Co to suggest that wireless networks should contribute to the cross-subsidy of the NBN Co rural obligations. It is also inconsistent with the Government policy that contribution be sourced from owners of NBN-equivalent high speed access networks; and does not result in additional costs to consumers.

2.9 Optus fully supports the statement from BCR that "*industry funding eligibility should be based on a service standard relative to owners of high-speed broadband access networks, consistent with the Government's policy objectives. This approach would not include mobile broadband networks.*"[7]

[7] BCR, 2015, NBN non-commercial services funding options, consultation paper, p.27

Section 3. COMMENTS ON NBN CO'S PROPOSALS

3.1 NBN Co submits that any levy should include services which are close substitutes to those provided over the NBN Co network including mobile data and broadband services.8 NBN Co prefers a revenue based levy across all retail providers so not to unduly impact network operators. NBN Co argues this would be an equitable outcome as it would minimise the deadweight loss of any price increase due to the levy.[9]

3.2 These statements are in direct contrast to the Australian Government policy, which requires contributions from <u>owner of high speed broadband access</u> and to require that <u>consumers face no additional costs</u>.

3.3 Optus reiterates that the policy intent of the explicit subsidy arrangement is to ensure that every superfast access fixed line in metro areas contributes to the rural cross-subsidy; to ensure parity across NBN Co and non-NBN Co fixed networks.

3.4 Even if it was within the scope of this Inquiry to consider including mobile networks, there is no legitimate policy reason to do so. It is important to note that:

(a) Cross-subsidy levy is not to compensate for a general shortfall in revenue;

(b) Reducing any potential competitive pressure from mobile broadband may lead to higher expenditure and prices from NBN Co; and

(c) There can be no non-commercial areas if mobile is considered a true substitute.

3.5 These are discussed below.

Cross-subsidy levy does not compensate NBN Co for lack of profits

3.6 The purpose of this Inquiry is to replace *the current opaque NBN Co cross-subsidy* **embedded in its wholesale access prices** *with more transparent funding arrangements*. This does not extend to imposing an industry tax to compensate NBN Co for lack of revenue growth.

3.7 NBN Co may be concerned that mobile-only households could impact upon its business case. This was recognised in the original NBN Co Corporate Plan. It has long been recognised that the financial assumptions underpinning NBN Co's Corporate Plans would be made more challenging should mobile only household increase above that assumed by NBN Co.

3.8 The NBN Co Corporate Plan 2011-13 highlighted that "*advanced mobile network could provide a competitive threat*."[10] NBN Co assumed that 13% of total residential occupied premises being wireless-only in 2010, increasing to 16.3% by FY2025 and 16.4% by FY2040.[11] This assumption formed a key component of NBN Co's original corporate plan. NBN Co reaffirmed this view in the Corporate Plan 2012-15, stating that residential wireless-only homes are within expectations.[12]

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[8] NBN Co, Submission to discussion paper, p.12

[9] NBN Co, Submission to discussion paper, pp.16-7

[10] Corporate Plan 2011-13, p.29

[11] Corporate Plan 2011-13, p.49

[12] Corporate Plan 2012-15, p.49, 55

3.9 The Strategic Review noted that NBN Co cumulative revenue for 2011-21 appears to be ~$0.2-0.3 Billion lower driven by an accelerated migration to mobile-only households.[13] It also noted that there is a risk to NBN Co achieving the assumed ARPU growth due to mobile broadband.[14] There was also a risk that as NBN Co increased prices, more end-users would move to wireless-only, thereby creating need for further NBN Co price increase; and so on.[15]

3.10 From its inception, it has been recognised that there are revenue sufficiency risks in NBN Co's long term corporate planning. The risks are driven by end-users choosing not to take-up a connection, and/or not to take-up greater capacity.

3.11 But the purpose of this Inquiry is not to compensate NBN Co for external risks to its business planning process – or to guarantee future revenue streams. The current Inquiry is to identify the internal cross-subsidy embedded in current NBN Co pricing – which assumes a level of external revenue risk.

3.12 There are a range of external revenue sufficiency risks – one of which is the take-up of wireless-only households – but the purpose of the rural cross-subsidy work is to identify the *internal* cross-subsidy in NBN Co pricing.

Taxing mobile will increase total cost of NBN Co

3.13 The Government's response to Vertigan states that the transparent funding arrangement would result in no additional costs to consumers relative to current NBN pricing. However, taxing mobile services – reducing the level of potential competition – will reduce the revenue sufficiency risk faced by NBN Co; a key driver to invest, operate and price efficiently. It is likely to not only increase mobile pricing but also NBN Co's pricing.

3.14 The presence of a competitive fringe of mobile-only households was recognised by NBN Co as a key driver of ensuring efficient expenditure, operations and pricing. During the development of its Special Access Undertaking (SAU), NBN Co argued for light-handed price regulation as it faced market incentives to promote take-up and usage. This was referred to as the revenue sufficiency risk. And it was referred to by the Department, ACCC and NBN Co to argue that light-handed price regulation was appropriate.

3.15 NBN Co itself argued that the potential for end-users to *choose* mobile broadband instead of an NBN connection was an important driver of efficiency in NBN Co. It is claimed that NBN Co faces incentives to price in such a way as to ensure the growth of downstream services in the presence of potential competition from mobile networks.[16]

3.16 NBN Co's pricing construct was accepted by the ACCC in part because NBN Co faced a level of revenue sufficiency risk, that "if it were to be unresponsive to these incentives, it may result in slower than forecast migration to the NBN, slower than forecast overall revenue growth, and higher than forecast losses of potential end-users to wireless-only supply".[17] The argument that NBN Co, over time, would face competition from other technologies (such as wireless) was a reason that the revenue sufficiency risk (combined with price controls) would ensure that NBN Co faced incentives to invest, operate and price efficiently.[18]

[13] Strategic Review, Final Report, p.58

[14] Strategic Review, Final Report, p.59

[15] Strategic Review, Final Report, p.106

[16] NBN Co, SAU Supporting Submission, 2012, pp.108, 176

[17] NBN Co, 2013, Submission to ACCC Consultation Paper on variation of NBN Co SAU, May, p.60

[18] NBN Co, 2013, Submission to ACCC Consultation Paper on variation of NBN Co SAU, May, p.60

3.17 Yet, in its submission to the BCR, NBN Co is requesting that taxes be placed upon mobile networks in order to diminish the potential competitive pressure – that is, it is asking for the Government to remove a driver of efficiency. This would result in higher prices for wireless broadband products, and is also likely to result in higher prices for NBN services, as NBN Co would incur additional costs and lose efficiency incentives.

3.18 As mentioned above, the presence of wireless broadband is likely to place an element of cost discipline on NBN Co. It is not cherry-picking as it does not preclude NBN Co from acquiring customers: end-users will still have access to NBN Co products. Some consumers may decide to adopt wireless instead of NBN Co services. The vast majority will see the two as complimentary and acquire both. The split of substitutes and compliments will be largely determined by the efficiency of NBN Co and/or Mobile Network Operators.

There is no requirement for cross-subsidy if mobile broadband is a substitute

3.19 If the BCR was to accept the proposition put by NBN Co, that mobile broadband was a substitute for NBN Co's products across the market, there would be little, if any, requirement for a cross-subsidy for non-economic areas.

3.20 Optus notes that throughout NBN Co's submission, it refers to the natural monopoly characteristics of fixed line telecommunications infrastructure. NBN Co state:

(a) It is the natural monopoly characteristics of the NBN which results to the concerns about cherry-picking and the need to ensure metro fixed line network contribute to the cost of the rural NBN.

(b) The natural monopoly characteristics of networks, particularly in rural areas, means that it is unlikely to be efficient to encourage the deployment of duplicate networks.[19]

3.21 NBN Co argues that it is building a network with natural monopoly characteristics, which means it provides non-contestable rural services; and it would incur inefficient costs in the presence of metro cherry picking.

3.22 Optus does not disagree with these statements. The policy justification for the NBN project is the natural monopoly characteristics of next generation fixed line broadband networks. There are public benefits from having a national, wholesale-only monopoly provider of next generation broadband services.

3.23 However, NBN Co also presents the counter argument that mobile broadband is a close substitute for NBN services – and as such, mobile broadband networks should be taxed to pay for NBN Co's rural wireless network. NBN Co proposes that any funding for the NBN Co rural network should apply to wireless broadband services.

3.24 These statements on funding are inconsistent with the position put to justify the existence of a levy. Once cannot be a natural monopoly and run a non-replicable network if there is a competing network already in place which can deliver substitutable products.

3.25 Optus submits that the BCR should recognise what the claims to include wireless broadband in the levy are truly about – a request from NBN Co to protect its business case from growth of mobile-only households. The Government, NBN Co and the ACCC have all previously recognised that potential competition from wireless broadband will help ensure NBN Co operates efficiently even in the absence of direct fixed competition.

[19] NBN Co, Submission to discussion paper, p.10

Conflict of interest with NBN Co

3.26 Finally, Optus notes that there is a concerning conflict of interest in NBN Co making a submission of this nature to the BCR inquiry.

3.27 NBN Co's proposal goes well beyond the BCR's remit of ensuring that there is a level playing field between NBN Co and owners of alternate fixed line broadband networks. Ultimately, its goal appears designed shift costs off the users of the NBN onto mobile networks. It would be tempting for policymakers to look at this as an opportunity to plug gaps in NBN Co's financial projections.

3.28 The BCR should recognise this conflict and reject NBN Co's proposal to broaden the scope of the proposed levy. The Inquiry should not expand into a wider discussion on industry taxation to support the business case of NBN Co. Should NBN Co face challenges in meeting its business case it should not be requesting the Department tax industry. If this were to occur, it would remove all source of 'revenue sufficiency risk', which has been identified as the efficiency incentive for NBN Co.