



Submission in response to

**NBN non-commercial services funding
options final consultation paper**

November 2015

INTRODUCTION

1. Optus welcomes the opportunity to provide some brief comments on the Bureau of Communications Research's final consultation paper on the funding options for non-commercial NBN services.
2. In summary, Optus supports the funding arrangements recommended in the report in respect of the likely losses associated with NBN Co's fixed wireless and satellite networks.
3. In particular, Optus strongly endorses the proposal that the funding arrangements should be based on an NBN equivalent approach that seeks to apply a levy only to those services that will directly compete with NBN Co in the wholesale market. This is consistent with both economic theory and the commercial rationale for the levy. It will ensure that NBN Co can continue to fund the loss making fixed wireless and satellite networks in the face of wholesale network competition from alternate superfast fixed networks since services provided over the access lines of those networks will make a levy contribution that would otherwise have been recovered in NBN Co's access charges.
4. The alternative approach proposed by NBN Co to apply a broad based levy cannot be justified as it would result in costs being loaded onto services that do not compete with the wholesale fixed line NBN. Such a levy would in effect act as an NBN-tax on mobile and corporate end-users.
5. Consistent with the approach taken to modelling costs for other regulatory decisions, Optus recommends that the BCR makes its modelling available for industry consultation prior to finalising any funding mechanism. Such consultation will be important in testing the validity of the assumptions and accuracy of the calculations used in the modelling. It will also help to ensure that forecasts of costs used in the model remain consistent with prudence and efficiency principles.
6. Optus has set out further detailed comments on the recommendations in the report below.

PROPOSED FUNDING ARRANGEMENTS

7. The Government has asked the BCR to provide advice on options for direct industry funding of the NBN non-commercial areas to replace the current arrangements whereby NBN Co fully funds the losses through a non-transparent internal cross subsidy in wholesale access charges. The Government indicated that its aim is to replace the current cross-subsidy 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".¹

8. The BCR has proposed the establishment of a per-service in operation levy with the levy to be applied to NBN Co and "NBN equivalent industry participants". Under this approach all in-use fixed access lines that deliver high speed broadband services to end-users will contribute

¹ Australian Government, 2014, Telecommunications Regulatory and Structural Reform, December, Section 2.6

equally to funding the non-commercial services regardless of whether the line is owned by NBN Co or another provider. This meets the Government's objective of ensuring that funding arrangements for NBN Co's non-commercial areas are; efficient; transparent; and remain sustainable in the face of competition to the NBN.

9. Optus supports the new funding arrangements proposed by the BCR.
10. The NBN has been established to be the national provider of fixed high speed broadband services. It was initially anticipated that NBN Co would have a monopoly over the provisions of these services. The costs of supporting the loss making fixed wireless and satellite networks are included in NBN Co's wholesale access charges which are set on a geographically uniform basis. Since NBN Co was unlikely to face any competition, this approach would ordinarily ensure that the losses associated with NBN Co's rural fixed wireless and satellite services would be internalised and self-funded from the wholesale charges on NBN Co's metropolitan services.
11. With the shift to a multi-technology mix, NBN Co faced the prospect of some limited network competition with the announcement of fibre to the basement (FTTB) network roll-outs to the large apartment buildings in metropolitan areas. This raised two central issues for the NBN policy; first, the cross subsidy built in to NBN Co's wholesale access charges for the rural losses would limit its ability to respond to competitive offers by these alternate providers; and second, competition from these providers would result in revenue leakage which would reduce NBN Co's ability to self- fund those losses.
12. The levy proposed by the BCR addresses each of these issues. It will ensure that where a high speed broadband service is provided over an access line operated by an alternate network provider then that service will make the contribution to the rural loss that would otherwise have been made by an NBN service. On this basis the proposed levy achieves equity between NBN Co and owners of alternate high speed broadband networks. It will also plug any gaps in funding the rural loss as a result of revenue leakage from competition.
13. This approach explicitly rejects proposals from some industry participant (notably NBN Co) that the levy should be applied to a broader set of services such as mobile services. In rejecting a broader based funding model the BCR noted that limiting *"the eligibility to NBN equivalent services is the most economically efficient way of achieving a competitively neutral funding mechanism for the fixed wireless and satellite losses, while freeing up infrastructure competition"*.
14. Optus strongly agrees with the BCR's reasoning on this point. Limiting the eligibility to only NBN equivalent services is likely to mean that the vast bulk of the losses are accounted for in NBN Co's access charges. This will provide strong incentives on NBN Co to run those networks efficiently and minimise any losses it realises.
15. However, Optus would go further and suggest that there is no sound economic or policy basis for the levy to be applied beyond NBN equivalent services. If a levy is applied to a broader set of charges then the cross-subsidy included within NBN Co's wholesale access charges would

ordinarily have to be removed or reduced². Failure to make such an adjustment would amount to tacit recognition that the NBN roll-out can no longer be fully self-funded and that revenues would be required from other sources. Imposing a levy on other services would amount to an NBN tax on the users of mobile and corporate networks services to recoup such revenue.

QUANTIFYING LOSSES

16. The BCR has recommended the following approach be applied to quantifying the losses that are likely to be associated with NBN Co's fixed wireless and satellite networks:
 - a. Costs should be determined on an avoidable cost approach to take account of the directly attributable costs of those services and a share of common costs that would otherwise be avoided if the fixed wireless and satellite networks were not rolled out;
 - b. Costs are to be measured on an aggregate basis rather than a cluster basis; and
 - c. The measurement timeframe is proposed to be to FY2040.
17. Optus agrees with the above approach since it is likely to provide a reasonable basis for quantifying any losses associated with fixed wireless and satellite networks.

MODELLING APPROACH

18. The BCR has recommended the following approach is applied to modelling the losses likely to be associated with NBN Co's fixed wireless and satellite network:
 - a. A discounted cash flow (DCF) methodology is proposed to be used rather than the building block approach;
 - b. The discount rate used in the modelling is 6.46 per cent consistent with that used in NBN Co's SAU; and
 - c. The BCR has used NBN Co's projections to FY2022 and then applied a steady state or continued past trends in costs or revenue assumptions.
19. This approach does not appear to be unreasonable in principle. However, without visibility of modelling and the full range of assumptions it is not possible for Optus to opine as to whether the detailed assumptions are reasonable. Nor can we express a firm view as to whether the estimated \$9 Billion of losses estimated by the BCR for the NBN fixed wireless and satellite networks represents a fair and accurate measurement. The loss is significant and based on information provided publicly it suggests that these networks require a subsidy of around \$1Billion per annum once steady state is achieved.
20. Optus recommends that, consistent with the approach taken to modelling costs for other regulatory decisions, the BCR should make its modelling available for industry consultation prior to finalising any funding mechanism. Optus recognises that much of the data may be

² NBN Co's charges would have to be reduced by the difference between the levy calculated under an NBN equivalent basis and the levy calculated under the broader approach

commercially sensitive – although forecasts for FY2021 have been released publically – but access could be provided under appropriate confidentiality agreements as is the case with other regulatory pricing decisions. Such consultation will be important in testing the validity of the assumptions and accuracy of the calculations used in the modelling. It will also help to ensure that forecasts of costs used in the model remain consistent with prudence and efficiency principles.

21. On a point of detail Optus questions the validity of the reference in chapter 7 to the percentage of households that are mobile only, i.e. will not acquire NBN fixed services. The BCR references ACMA sponsored marketing research which claims 21% of ‘people over 18’ who use mobile internet only and do not have a personal fixed connection.³ It appears that the BCR report uses this 21% figure as the number of households that would not acquire a NBN connection.
22. Optus does not agree that this is the correct assumption to use for modelling purposes.
23. First, it is inconsistent with NBN Co’s view on the percentage of mobile exclusive household – that is, households that would eschew fixed NBN connection after full roll-out.
24. The BCR relies upon the NBN Co Corporate Plan for much of its NBN-related data inputs. Optus recommends for consistency it should rely upon NBN Co current and long terms views on the percentage of mobile-only households – that is, households that have access to NBN network connection but choose to avoid a fixed NBN service. 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 FY2040.⁴ This assumption formed a key component of NBN Co’s original and subsequent corporate plan. NBN Co reaffirmed this view in the Corporate Plan 2012-15⁵ and again in the 2016 Corporate Plan⁶, stating that residential wireless-only homes are within expectations.
25. Second, it is not clear that the focus on internet-only is the correct interpretation. Reference should be to mobile-only households that have neither a fixed voice nor internet connection. Voice-only retail connections should not be over-looked as (a) NBN Co receives the same access fee for voice as data; and (b) recent RSP data shows around one quarter of NBN connections are for voice-only services.⁷ The ACMA commissioned marketing research shows that only 12% of adult Australians had neither fixed line voice nor internet at their home.⁸ This figure is consistent with the NBN Co assumptions. Optus further notes that this approach is also consistent with NBN Co’s use of the same Roy Morgan research method, which compared households without any form of fixed connection to its Corporate Plan assumptions.⁹

³ <http://www.acma.gov.au/theACMA/engage-blogs/engage-blogs/Research-snapshots/Australians-get-mobile>

⁴ Corporate Plan 2011-13, p.49

⁵ Corporate Plan 2012-15, p.49, 55

⁶ NBN Co, Corporate Plan 2016, p.49

⁷ Telstra, 2015, Full Year 2015 Financial Results – CEO/CFO Analyst Briefing Presentation, p.13

⁸ <http://www.acma.gov.au/theACMA/engage-blogs/engage-blogs/Research-snapshots/Australians-get-mobile>

⁹ NBN Co, 2012, Corporate Plan 2012-15, p.55

ADMINISTRATIVE ARRANGEMENTS

26. The BCR has made the following recommendations in respect of the administration of the proposed funding arrangements:
27. A periodic re-forecasting of the losses should be undertaken by the ACCC, ACMA or the Department of Communications. Such a review and re-set of pricing should occur at least every five years or more frequently if the circumstances require;
 - a. Any funding should be collected by the ACMA;
 - b. Transparency should be promoted by publishing the process for calculating the funding contributions and the per-SIO amount calculated; and
 - c. Implementation of contestability arrangements is considered premature.
28. Optus supports these recommendations.

INTERACTION WITH OTHER REGULATORY ISSUES

29. In the initial industry consultation a number of organisations argued for funding of the non-commercial service to be considered as part of a broader reform of the USO. Whilst noting these arguments the BCR has concluded that proposals to harmonise the funding levy with the existing USO is outside the terms of reference of its study.
30. Optus concurs with this conclusion. Further, Optus notes that it would be wrong to conflate the existing USO levy arrangements with the proposed NBN Co non-commercial funding arrangements. The objectives of these two schemes are quite different. The purpose of the NBN non-commercial services levy is to ensure that NBN Co is not disadvantaged when it faces competition from alternate providers in metropolitan areas by virtue of the fact that its metropolitan charges must fund the loss making regional areas. The levy will achieve a level playing field in this respect by ensuring that any service provided by an alternate superfast network that displaces the NBN will make the same contribution to fund the loss making fixed wireless and satellite services as would be made if the service was provided by the NBN.
31. In contrast the USO funding operates to ensure that all users are provided with a basic level of voice service wherever they reside.