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# Telstra submission to the Bureau of Communications Research NBN non-commercial services funding options Final Consultation Paper

**6 November 2015**

## Executive summary

The Bureau of Communications Research's (BCR) recent Final consultation paper '*NBN non-commercial services funding options'* (**the paper**) presents a cost assessment for the provision of nbn's 'non-commercial services' (defined as nbn's fixed wireless and satellite services) and discusses two options for the funding of these costs via industry contributions. Administrative arrangements and a number of other regulatory issues are also considered.

Telstra supports many of the preliminary findings in the paper. However, we are concerned by several issues that are central to the successful design and implementation of the new funding arrangement:

- Funding liability provisions; and
- fairness for consumers.

The current eligibility criteria need to be more closely linked to the problem being addressed – the adverse impacts on nbn's business case that result from the emergence of competing fixed line infrastructure in metropolitan areas (often referred to as revenue leakage). Liability to fund the levy should be confined to NBN-equivalent networks *that are a source of revenue leakage for nbn*, and exclude networks that are not competing with nbn or will be overbuilt by nbn. This approach allows the levy to precisely target the revenue leakage problem and equitably give effect to the Government's level playing field objective, while also providing incentives for nbn to pursue its national fixed network rollout.

The design of the levy arrangements should deliver fair outcomes for consumers. Targeting funding liability to NBN-equivalent networks that are a source of revenue leakage for NBN will deliver the best possible outcomes for retail customers, by providing a sustainable levy arrangement that facilitates nbn's efficient roll-out of services with minimal impost on other services. Customers with non-NBN services may already fund cross-subsidies on their own service networks – levying a broader base would mean these customer were also burdened with funding nbn's cross-subsidy.

The levy's funding objectives can be most effectively balanced with the problem it is proposing to address and the need to deliver fair outcomes for consumers by implementing clear eligibility criteria to determine liable networks. Refining liability to NBN-equivalent networks that are a source of revenue leakage for nbn would protect nbn's ability to fund non-commercial services from the impact of emerging infrastructure competition within its footprint, while ensuring that networks that do not compete with nbn, and their customers, are not unduly burdened by levy arrangements.

## Introduction

Consideration of a new NBN non-commercial services funding arrangement is part of the continuing transition to new regulatory and structural arrangements for Australia's telecommunications sector. This follows the Government's adoption of a multi-technology mix model for the NBN, completion of the Vertigan Review and the release of the Government's policy response to that review in December 2014.

Central to this transition is the switching off of various legacy networks and the migration of customers to other (predominantly NBN) networks. While nbn is required to provide high-speed broadband to all Australian premises at affordable prices, and is expected to be the primary provider of wholesale services for many years, the unanticipated emergence of new fixed line competition has focused attention on creating a level playing field so that innovation and efficiency can be harnessed to drive improved outcomes for customers.

The Bureau of Communications Research's (BCR) recent Final consultation paper '*NBN non-commercial services funding options'* (**the paper**) presents a cost assessment for the provision of nbn's 'non-commercial services' (defined as nbn's fixed wireless and satellite services) and discusses two options for the funding of these costs via industry contributions. Administrative arrangements and a number of other regulatory issues are also considered.

Telstra supports many of the preliminary findings in the paper. However, we are concerned by several issues that are central to the successful design and implementation of the new funding arrangement: funding liability provisions and fairness for consumers.

## The problem to be addressed by a new NBN non-commercial funding arrangement is clear

The problem targeted by the proposed funding arrangement is clear –the unanticipated emergence of competing fixed line infrastructure is impacting nbn's business case. Benefits including improved efficiency could also come from is increasing transparency around the cost of providing non-commercial services.

This view was outlined in our submission to the BCR's initial consultation, and is consistent with the findings of the Vertigan Review. The BCR notes that the Vertigan Review 'found that (current) cross-subsidy arrangements do not support transparency or contestability for service delivery in regional areas, and subsidy sources are likely to be eroded over time by entrants attracted to compete with nbn in areas where nbn prices are above the costs of an efficient competitor.'[1]

This view of the problem is also consistent with terminology used in the BCR's paper – such as 'cross subsidy issue' and 'cross subsidy leakage'[2].

The original nbn business case included an internal cross subsidy. However, the capacity of this measure to fund the ongoing provision of nbn's non-commercial services has been impacted by 'entrants attracted to compete with nbn in areas where nbn prices are above the costs of an efficient competitor'. The BCR specifically identifies these areas as 'lower cost urban areas', which is consistent with the focus of nbn's competitors on connecting high speed broadband networks to metropolitan multi-dwelling units in recent times.[3] This market entry by competitors results from a legislative loophole and an easing of measures which protected nbn from competition.

The BCR's proposed solution should be tightly focused on this problem, particularly in terms of eligibility for the new funding arrangement.

## The definition of non-commercial services is pragmatic

Telstra supports the BCR's definition of NBN non-commercial services as all of nbn's fixed wireless and satellite services at aggregate network levels. This definition is pragmatic, noting there is no provision for excising clusters of profitable fixed wireless or satellite services, or including specific fixed line areas even if they are loss-making. However, it should be recognised that those parts of nbn's business will need to face strong profit incentives to ensure they minimise the loss of delivering those services. Without such

[1] BCR, Initial consultation paper, NBN non-commercial services funding options p7
[2] BCR, Final consultation paper, NBN non-commercial services funding options pp13, 54
[3] BCR, Initial consultation paper, NBN non-commercial services funding options p 11

incentives, the fixed wireless and satellite parts of nbn may become less efficient over time – a common risk associated with subsidy recipients.

### The quantification of the cost of non-commercial services is reasonable

Telstra supports the BCR's proposal to use an avoidable cost approach for quantifying the cost of providing nbn's non-commercial services. This approach is reasonable given the broad and multi-purpose nature of nbn's assets. It will result in the inclusion of costs directly attributable to the provision of fixed wireless and satellite services, and the share of common costs that would have been avoided if the fixed wireless and satellite networks were not rolled out. This approach will minimise the impact of the levy on commercial customers, while continuing to provide incentives for nbn to continue to supply non-commercial services.

Based on the use of avoidable cost approach, the BCR has estimated that the net cost for delivering nbn's non-commercial services over the period until FY2040 is $9 billion. This estimate translates to approximately $100 per fixed wireless SIO and $120 per satellite SIO per month in 2015 real terms.

Additional detail on how the BCR has calculated the $9 billion figure would be welcome. In particular, the BCR's analysis is largely silent on which specific costs and revenues are included, and does not comment on the approach to instances of any NBN self-service or future product offerings which may use the infrastructure funded by the levy.

### Liability for the funding arrangement should be refined

The BCR's paper broadly considers two options for the non-commercial services funding arrangement: an NBN equivalent approach and a wider industry funding base approach.

Under an NBN equivalent approach, contributions to the funding of non-commercial services would be sourced from operators of high-speed fixed line access networks (i.e. 'equivalent services'). Under a broader approach contributions would be sourced from the whole telecommunications industry. Of these two alternatives, the paper indicates a preference for the NBN equivalent approach as this is considered 'the most economically efficient way of achieving competitively neutral funding of fixed wireless and satellite losses, while freeing up infrastructure competition'.[4] We support the BCR's view that this approach 'provides strong incentives for the nbn Board to minimise fixed wireless and satellite losses' by ensuring that nbn remains strongly accountable for these losses due to the need to largely fund them from its fixed line customers.[5]

In terms of liability under a NBN equivalent approach, the BCR proposes:

- Industry participants that resemble nbn will be liable. This liability is based on network operators of high-speed fixed line broadband access networks delivering download speeds of at least 25 Mbps to residential and small business customers
- Mobile networks will be excluded, as they are not considered to be NBN-equivalent services.
- Networks serving government and medium and large businesses will be excluded
- Networks that are being transferred to nbn under the Definitive Agreements (legacy copper and HFC networks) will be excluded (noting the customers on these networks will be included in the funding base once they have been transferred to nbn)
- Any high-speed fixed line services in the NBN fixed wireless and satellite footprint will be excluded in the interests of encouraging efficient new infrastructure investment.

Telstra supports the BCR's proposal to adopt a narrower, NBN-equivalent funding arrangement in preference to a broader industry levy. However, the funding liability criteria need to be further refined and more closely linked to the problem to be addressed.

Liability to pay the levy should be confined to NBN-equivalent networks *that are a source of revenue leakage for nbn*. This approach allows the levy to be precisely targeted at the revenue leakage problem and equitably give effect to the level playing field objective, while also providing incentives for nbn to be efficient and innovative in the roll-out of its networks. At present the eligibility criteria fail to capture

[4] Ibid, p49
[5] Ibid, p53

important nuances between different networks that are in operation (or planned), and their relationship with the problem at hand (i.e. revenue leakage). These nuances are set out below.

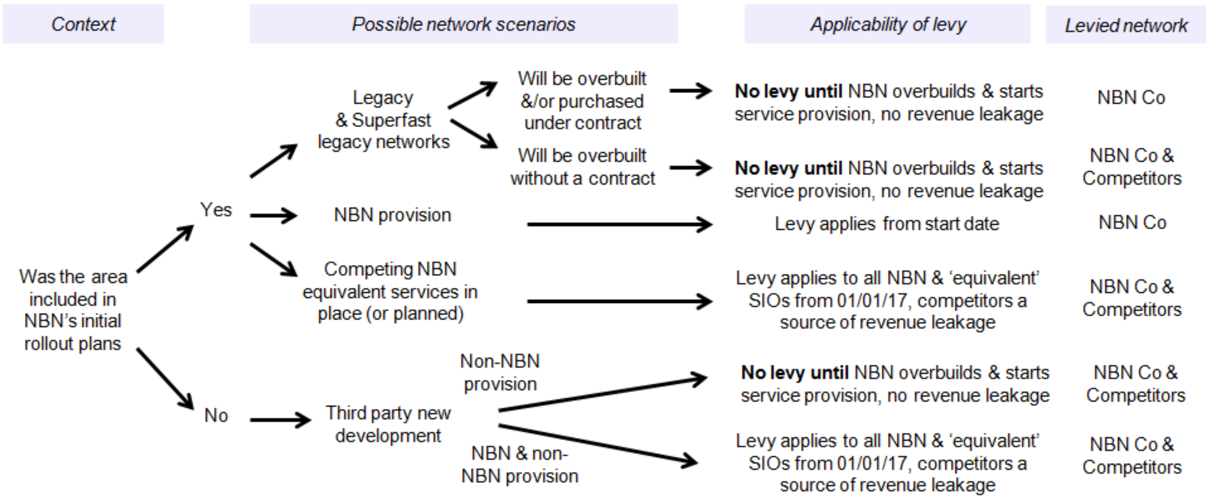
**Distortion of rollout incentives**

Failing to link the levy to sources of revenue leakage may have unintended consequences on nbn's rollout incentives. Presently nbn is incentivised to saturate coverage within the 93% footprint as it will obtain revenues from the provision of services. Allowing nbn to gain revenues from networks in areas it does not have its own competing infrastructure could be a disincentive to nbn rolling out infrastructure to those areas.

**NBN-equivalent networks that are a source of revenue leakage**

Figure 1 below sets out Telstra's view of the networks that are equivalent to NBN, and whether they are a source of revenue leakage for nbn.

**Figure 1: Possible network scenarios and levy interface**




<u>Legacy networks that will be overbuilt and disconnected or purchased under contract</u>

The paper excludes Telstra and Optus' copper access and HFC networks from funding liability on the basis that including these networks for the short period of time until they are transferred to nbn would create an undue compliance burden. Further, these networks are neither a source of revenue leakage for nbn nor in competition with nbn for SIOs and will be switched off as they are overbuilt by nbn and migration occurs.

The Velocity networks should be excluded because they have the same attributes as legacy copper and HFC networks – under the Definitive Agreements they will be switched off as they are overbuilt by nbn, therefore they are neither competing with nbn nor a source of nbn revenue leakage.

Legacy networks that may be overbuilt without a contract

There are a number of superfast fixed line broadband networks that predate the nbn and operate in areas where nbn does not currently provide services, but may choose to overbuild or acquire these networks as the rollout progresses. For example, nbn does not currently provide services in the South Brisbane fibre network area, but may later choose to acquire or overbuild this network to deliver NBN services, similar to its purchase of the TransACT FTTP network in the ACT in 2013.[6]

Fibre-based, superfast legacy networks which pre-date the NBN should not be included in the levy arrangement. As they were not in the original NBN rollout plan they do not compete with nbn and are not a source of revenue leakage for nbn. It would be unreasonable, and somewhat arbitrary, for the levy to be imposed on end-users in areas where NBN is neither operating nor intending to operate. These networks are clearly distinct from networks which directly compete with nbn in FTTB areas.

If NBN chooses to subsequently enter areas where superfast legacy networks exist (or acquire these), the levy could be applicable from the time they are deemed ready for service by. This approach supports efficiency and reinforces incentives for nbn to manage their costs in a disciplined way.

NBN service provision

Telstra agrees with the BCR's view that nbn's SIOs should be included in the levy. These SIOs are the key source of nbn's revenues and ability to fund the provision of non-commercial services.

Competing NBN-equivalent services

NBN-equivalent services that operate or are planned in areas where nbn also provides services should be subject to the levy. The emergence of these fixed line infrastructure competitors in NBN areas are a source of revenue leakage to nbn, and have a direct impact on nbn's business case and ability to fund non-commercial services.

Third party new developments with no NBN services in operation

A number of high speed fixed line broadband networks operate in third party estates where nbn does not currently provide services. If nbn wishes to roll out services to these areas, it must seek approval from its shareholders to provide these services.

The levy should not apply to networks operating in new developments where nbn does not provide services. As these networks are outside nbn's footprint, they are not a source of revenue leakage for nbn. As highlighted above, providing nbn with the opportunity to seek funding from networks in areas where it does not compete would be contrary to the BCR's stated intention of providing nbn with incentives to minimise its costs.

Third party new developments with NBN and non-NBN services in operation

Where non-NBN networks operate in new developments where nbn also provides services, the levy should apply. These networks are competing directly with nbn and are therefore a source of revenue leakage.

**Liability of networks serving medium and large businesses**

Telstra supports the paper's proposal to exclude networks providing high speed broadband services for medium and large businesses from liability. These networks are not a source of revenue leakage from nbn, whose business case is premised on the rollout of services to residential and small business customers. Further, Telstra agrees with the BCR's views that including these networks would foster undue administrative complexity and regulatory uncertainty.[7]

**Threshold for funding levy eligibility**

The paper also states that an eligibility threshold based on revenues or SIOs should be considered to ensure that the administrative costs of compliance and collection are not disproportionate to the amount collected.[8]

[6] nbn Media release, 22 May 2013, http://www.nbnco.com.au/corporate-information/media-centre/media-releases/nbn-co-deal-with-transact.html
[7] Ibid, p57
[8] Ibid, p59

Consistent with the Government's commitment to minimise unnecessary regulatory burdens on industry,[9] an eligibility threshold may be appropriate to ensure that networks with only a small impact on nbn's revenues and ability to fund non-commercial services do not face a disproportionate compliance burden.

### Impacts of funding arrangements on customers should be considered

Determining which networks are liable for these funding arrangements will have important downstream impact on customers of superfast broadband services. Customers are best served by a sustainable levy arrangement that is precisely targeted to facilitate nbn's efficient roll-out of services, with minimal impost on services that do not impact the roll-out. Funding arrangements should also deliver fair outcomes for these customers by taking into account any internalised cross-subsidies that retail and wholesale customers may already pay on non-NBN broadband services. In particular, if customers already pay nationally averaged prices for their non-NBN services delivered on a national network, they are already paying an implicit cross subsidy on the service that they are using, that arises from their service provider's internal business model which allocates unequally incurred costs equally across its customer base. For those customers to then also pay for a cross subsidy on NBN services where they are not using these services or otherwise impacting NBN's business case will lead to inequitable outcomes for customers as they face the burden of paying cross-subsidies across two networks.

### Periodic review is appropriate

As the proposed levy arrangement will impose regulatory burdens on liable network operators, it is appropriate for this arrangement to be subject to periodic review as outlined in the paper. This will allow levy arrangements to be monitored to ensure that the costs of the scheme do not outweigh its benefits.

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[9] Department of Communications, *Deregulation in the Communications Portfolio*, November 2013 https://www.communications.gov.au/file/628/download?token=pil6pYe7.