Submission to the Joint Standing Committee on the National Broadband Network inquiry into the business case for the NBN and the experiences of small businesses

Introduction

Vocus is a specialist fibre and network solutions provider operating Australia's second-largest intercapital network. Vocus is also the fourth-largest retail service provider on the NBN via our Dodo, iPrimus, and Commander brands (along with Vocus' wholesale business), with over 465,000 connected users (7.5% market share).

In total, the Vocus terrestrial network is ~30,000km of high-performance, high-availability fibre-optic cable supported by 4,600km of submarine cable connecting Singapore, Indonesia and Australia and 2,100km of submarine cable between Port Hedland and Darwin connecting offshore oil and gas facilities in the Timor Sea. Vocus owns a portfolio of brands catering to enterprise, Government, wholesale, small business and residential customers across Australia and New Zealand.

Vocus welcomes the opportunity to provide this submission.

Executive Summary

Vocus is Australia's specialist fibre and network solutions provider. At Vocus, we believe in infrastructure competition and we are a committed infrastructure investor in Australia.

With this context, Vocus will concentrate our response on the Committee's Terms of Reference which address NBN's business in the competitive Enterprise (large business) telecommunications market.

Vocus submits that there is an underlying, fundamental problem with the NBN: the value of the NBN asset is far less than what it has cost to build. As a result, NBN's business strategy and decisions are being driven by unrealistic financial targets rather than policy outcomes, consumer needs, and market reality.

This core problem has resulted in NBN straying beyond its legislated remit as a wholesale-only, transparent and non-discriminatory provider as it pursues the revenues required to meet its financial targets. This problem manifests itself in NBN's behaviour in the competitive Enterprise market.

Vocus submits that the Committee should consider the impact that NBN's business case is having on private infrastructure investment; and assess whether NBN's actions to meet its financial targets will come at the cost of infrastructure competition.

Vocus proposes to respond to the Committee's Terms of Reference regarding:

- **Economics of the NBN:** NBN's business case has been designed to meet financial targets rather than policy outcomes, leading to mission-creep into well-served competitive markets
- **Business segment strategy**: NBN's behaviour in the competitive Enterprise market has seen it breach its wholesale-only mandate by engaging directly with end-users and overbuilding existing private networks
- **Statement of Expectations**: NBN's Statement of Expectations (SoE) should be updated to provide guidance on its policy objectives post-completion, particularly in regard to its role in the competitive Enterprise market

Economics of the NBN

The Government's policy objectives for the NBN include ensuring that "all Australians have access to very fast broadband as soon as possible, at affordable prices, and at least cost to taxpayers."

But because the real market value of the NBN is far less than what it cost to build, there is a conflict within this objective: NBN is required to deliver the network offering affordable prices at least cost to taxpayers, while at the same time generating a rate of return (RoR) on an asset which is overvalued – therefore requiring higher revenues to make that return.

Due to this failure to recognise the real underlying market value of the NBN, the company has been forced to engage in 'mission-creep' – drifting from its original intent as a wholesale-only provider in the monopoly residential broadband market, to encroach as a retail competitor in the competitive Enterprise market.

NBN's Corporate Plan provides only two references to its Enterprise financials: revenues of $388m in FY19, accounting to just under 14% of total revenues last year; and projected revenues of $1.2b in FY23 – accounting for 20% of its total revenues that year.[1]

Without this Enterprise revenue stream, NBN would be unable to turn cash-flow positive for the first time in FY23 without substantial increases to consumer broadband pricing (or other measures to make up for the shortfall) – impacting its ability to repay its $19.5b Commonwealth loan and meet the 3.2% RoR target on its $29.5b in Commonwealth equity.

This fact, however, should not be used as a justification for NBN's behaviour in the competitive Enterprise market. Rather, this fact underlines that NBN's Enterprise business is being driven by the need to meet a financial requirement – rather than any policy requirement – as the Enterprise market is already well-served by a number of competitive infrastructure investors.

The delivery of the business segment strategy

Executed appropriately, NBN's Enterprise business should be a good thing: it should improve competition in underserved areas; it should improve retail market competition by virtue of NBN's position as a wholesale-only, transparent, and non-discriminatory provider; and it should support and encourage more private investment. In this context Vocus has been, and continues to be, a supporter of NBN in Enterprise.

But the reality of NBN's behaviour in the Enterprise market has been very different to these expectations.

Rather than focussing on improving competition in underserved areas like regional Australia, NBN has been actively overbuilding competitive networks in well-served metropolitan areas.

Rather than improving retail competition as a wholesale-only, transparent, and non-discriminatory provider, NBN has gone beyond its wholesale-only remit by selling fibre-build services directly to end-users. NBN has discriminated between retail service providers (RSPs), as was recognised in a formal warning from the ACCC which "concluded that NBN Co failed to comply with its non-discrimination obligations on a number of fronts."[2]

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[1] NBN Corporate Plan 2020-23, p10 & p50
[2] ACCC, 'NBN given formal warning' 9/10/19

And rather than supporting and encouraging private investment, NBN is actively punishing investors by using its status as a taxpayer-subsidised, low-rate-of-return Government Business Enterprise to overbuild existing fibre and prioritise NBN fibre over its competitors.

Vocus calls on the Committee to make two key recommendations to ensure NBN meets its policy objectives in the Enterprise market:

1. NBN should honour its wholesale-only mandate and not engage directly with end-users
2. NBN should not overbuild competitive fibre

<u>1. NBN should honour its wholesale-only mandate and not engage directly with end-users</u>

Since its establishment, NBN has been required by legislation to act as a wholesale-only provider.

But in the competitive Enterprise market, NBN's 'industry engagement' staff effectively operate as a direct sales team by engaging with end-users to sell NBN's 'build' products (meaning the construction of new fibre). This activity puts NBN in direct competition to its wholesale customers, as it sees NBN:

- engage directly with end-users at the same time that RSPs are also engaging with those end-users
- enter direct contracts with end-users which set out buying commitments and terms of service, which may be different to the contract terms offered to RSPs
- advocate for end-users to take up a 100% NBN solution (even if the end-user's RSP already has existing fibre to their chosen locations)
- bind the end-user to contract terms which they must separately agree with their RSP
- sign confidentiality agreements with end-users, requiring end-users to seek NBN's consent to discuss contracts with their own RSP

NBN claims this conduct is within its wholesale-only remit as end-users must ultimately enter a contract with an RSP to connect a broadband service. But this claim ignores the fact that NBN's 'build' products are effectively retail products, as they are delivered in direct competition to RSPs which also build fibre networks. In the same way that RSPs may spread the up-front cost of fibre builds across multi-year service commitments, NBN also offers 'zero-cost' build contracts directly to end-users – but requires end-users to then enter contracts with RSPs where they commit to minimum bandwidth purchases.

NBN should not engage directly with end-users to ensure it operates solely within its wholesale-only remit; to reduce end-user confusion and conflict between RSPs and NBN's 'industry engagement' staff; and to ensure it does not gain an unfair advantage in the market due to its access to information about end-user requirements.

Shutting down NBN's direct sales function would be one avenue to prevent NBN from inappropriately discriminating between its wholesale customers. As previously noted, NBN was given a formal warning by the ACCC in October 2019 for discriminating between RSPs for Enterprise build services[3], resulting in the ACCC accepting a court-enforceable undertaking from NBN.

In its findings against NBN, the ACCC was satisfied that "NBN Co offered materially different commercial terms to different RSPs as it upgraded NBN infrastructure to support high-speed, business-grade services."

This issue is not limited to NBN's direct sales arm (which may offer different contract terms to end users compared to RSPs), but also NBN's wholesale arm (which was found to have offered different contract terms to different RSPs).

If NBN were acting as a wholesale-only operator, there should be no need for NBN to discriminate between its wholesale customers. But because NBN is effectively competing at the retail level by selling its build services directly to end-users, NBN is incentivised to favour RSPs which will use the greatest amount of NBN fibre (over other RSPs which would prioritise their own fibre assets over NBN wholesale fibre).

NBN's expansion of its channel partner program from an education initiative into a sales campaign with direct financial incentives is the latest example of NBN encroaching into the domain of RSPs.

The issue of NBN being a retail competitor to its wholesale customers is compounded by the fact that NBN has access to RSPs' information about end-user requirements. RSPs have limited legal protection from NBN sharing that information between its wholesale business and its direct sales staff – who can use that information to directly engage with end-users in an effort to sell 100% NBN fibre builds.

While NBN has recently sought to address this particular issue by implementing "Information Ringfencing Protocols"[4] following the ACCC's formal warning, industry is still expected trust NBN to implement these internal governance controls without appropriate regulatory oversight.

In the absence of a complete shut-down of NBN's direct sales team, at a minimum NBN's Enterprise business should be subject to separation requirements with equivalent regulatory oversight to Telstra's Structural Separation Undertaking (SSU). This should require NBN's wholesale staff to work separately from its direct sales staff; and should include legally enforceable 'Protected Information' requirements.

Under Telstra's SSU, "Telstra will not use or disclose Protected Information relating to a Wholesale Customer in a manner which would be likely to enable a Retail Business Unit to gain or exploit an unfair commercial advantage over that Wholesale Customer in any market."[5]

This same requirement should apply to NBN, at a minimum, to prevent NBN from exploiting RSP information to its own commercial advantage.

Additionally, in the absence of a shut-down of the direct sales team, NBN's non-discrimination obligations should apply equally to its contracts with both RSPs and end-users, which should be offered equivalent terms for Enterprise fibre builds.

2. NBN should not overbuild competitive fibre

Vocus sees a positive role for NBN in Enterprise where RSPs can work with end-users to determine the most economically efficient blend of their own fibre, NBN's

[3] https://www.accc.gov.au/media-release/nbn-co-given-formal-warning
[4] NBN email to RSPs, 'Business nbn RSP Bulletin - End User Deal Constructs', 19/12/19
[5] Telstra SSU, section 10.3

fibre, and that of any other wholesale provider. However, it is not economically efficient when NBN promotes its own fibre to the exclusion of all others.

Infrastructure investors are being undermined by tenders seeking 100% NBN fibre – favouring providers that have not invested in infrastructure over those that have built similarly-capable assets. This has long-term implications for the Enterprise market and the overall health of the communications sector.

In many areas, NBN has proactively overbuilt competitive fibre to attract new Enterprise customers, regardless of whether or not there was any demand for an additional fibre operator at those locations.

The overbuilding issue is closely connected to the issue of NBN engaging directly with end-users.

Were NBN adhering to its wholesale-only remit, RSPs would compete to provide the most cost-effective network proposal to meet an end-user's requirements. Such proposals may include a proportion of NBN fibre alongside the RSPs' own fibre, as well as fibre from other wholesale operators. In some cases, RSPs may decide to propose a 100% NBN solution as the most cost-effective option.

However, NBN's behaviour in the Enterprise market sees NBN enter direct contracts with end-users for 100% NBN fibre builds, with the proviso that the end-user must then enter into a separate agreement with an RSP to deliver the service. This approach leads to an absurd outcome where NBN overbuilds competitive fibre to deliver a 100% NBN solution – and an RSP may even find itself contractually required to use NBN fibre even at locations where they have their own fibre installed.

Further to this problem is that NBN may offer different contract terms to end-users compared to RSPs; and some RSPs may even be offered different contract terms to other RSPs (highlighted in the ACCC's formal warning to NBN).

Overbuilding existing competitive fibre to fulfil 100% NBN contracts is not only an irrational waste of NBN's taxpayer funding, it also strands existing assets and undermines private-sector infrastructure investment. This has long-term implications which, if uncorrected, risks private investment vacating the market; leaving the underlying infrastructure to be dominated by a Government-subsidised operator.

Vocus' own Melbourne office exemplifies this problem, where there are already six competitive private fibre providers – and NBN recently became the seventh.

NBN has considerable market power in the Enterprise market. NBN's Enterprise fibre lines are built as an extension of its Government-subsidised monopoly residential network, which extends NBN's fibre reach to within approximately 2.5km of more than 90% of Australian premises. Due to NBN's requirement to connect lift emergency phones and fire alarms, NBN's fixed-line footprint includes well-served buildings in major CBDs – even where there was no demand for NBN to provide broadband services to that building (Vocus' Melbourne office being a case in point).

As a result of NBN's requirement to build such a geographically-diverse fibre network for the residential market, NBN's incremental cost to extend this network to connect Enterprise customers is far, far lower than would be the case for a private-sector investor – giving NBN an unfair commercial advantage.

NBN's promotion of 100% NBN fibre contracts presents the danger of undermining and penalising those who have invested (and want to invest) in fibre to support infrastructure competition.

Compliance with the NBN Statement of Expectations (SoE) and adequacy of that Statement

Vocus submits that the current SoE is inadequate to provide NBN with clear policy objectives in the competitive Enterprise market, and an updated NBN SoE should specifically address the Government's policy expectations and provide certainty to both NBN and the market regarding the company's role in Enterprise.

An updated SoE should address the two key concerns described in the section above:

1. NBN should honour its wholesale-only mandate and not engage directly with end-users
2. NBN should not overbuild competitive fibre

NBN's existing SoE was published on the 24th of August 2016, a time when NBN's Enterprise business had not yet been established and therefore did not require any clear policy guidance from the Government.

Today, more than three years later, NBN's Enterprise business is generating annual revenues greater than $388m[6], forecast to increase to $1.2b by FY23[7].

Yet despite the fact that Enterprise will account for around 20% of NBN's total revenue in the next few years, the company is operating in something of a policy vacuum in this area.

The existing SoE does not contain a single direct reference to the Government's policy expectations for NBN in the Enterprise market, nor did the previous SoE documents published in 2013 and 2010.

The 2010 SoE expected NBN's footprint to include "Australian homes, schools and businesses", but this reference does not make a distinction between small businesses (which would be connected as part of the monopoly residential network, and served via residential-grade services), and Enterprise businesses (which are already served by a competitive market, via business-grade products that NBN only began offering as recently as 2018).

The 2010 SoE included the statement:

> "The Government does not expect NBN Co to inefficiently duplicate infrastructure existing (as at 1 January 2011) that can already support the provision of high speed broadband in accordance with the Government's broader NBN objectives"[8]

This principle could be expanded upon to provide guidance to NBN's behaviour in the Enterprise market.

Vocus proposes that the next SoE should be issued when the NBN network rollout is largely complete at the end of June 2020, as the company transitions from its rollout phase to its operational phase.

The next SoE should clarify the Government's policy objectives in the Enterprise market, which could include:

> In accordance with NBN Co's legislated mandate as a wholesale-only provider, the Government expects that NBN Co will engage exclusively

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[6] NBN Corporate Plan 2020-2023 p10
[7] NBN Corporate Plan 2020-2023 p50
[8] NBN 2010 Statement of Expectations

with retail service providers for Enterprise build and connectivity services; and NBN Co should not engage directly with end-users.

To strike the right balance between improving competition and incentivising private infrastructure investment, the Government expects that NBN Co will not promote 100% NBN fibre builds to end-users which result in the inefficient duplication of competitive infrastructure.

The Government expects that NBN will consistently behave in a wholesale-only, transparent, and non-discriminatory manner in the Enterprise market, providing equivalent contract terms and pricing to all RSPs (and only RSPs) for build services and broadband products.

These expectations would allow for NBN to play a constructive role in the Enterprise market: improving competition and allowing NBN to make a return, while also recognising the role of the competitive market and supporting private infrastructure investment.

Conclusion

Vocus supports infrastructure competition and we are a committed infrastructure investor in Australia.

Vocus submits that there is a fundamental problem with the NBN: the value of the NBN asset is far less than what it has cost to build. As a result, NBN's business case is being driven by unrealistic financial targets rather than policy outcomes, and this problem manifests itself in NBN's behaviour in the competitive Enterprise market.

Vocus sees a positive role for NBN in Enterprise where RSPs can work with end-users to determine the most economically efficient blend of their own fibre, NBN's fibre, and that of any other wholesale provider.

Vocus calls on the Committee to make two key recommendations to ensure NBN meets its policy objectives in the Enterprise market:

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Vocus submits that the current SoE is inadequate to provide NBN with clear policy objectives in the competitive Enterprise market, and an updated NBN SoE should specifically address the two key concerns described above.