

1 Introduction

The Senate Environment and Communications Legislation Committee (**Senate Committee**) is currently conducting an inquiry into:

- the Telecommunications Legislation Amendment (Competition and Consumer) Bill 2017 (**the CC Bill**); and
- the Telecommunications (Regional and Broadband Scheme) Charge Bill 2017 (**the RBS Bill**),
(referred to collectively as **the Amendment Bills**).

According to the explanatory memorandum to the CC Bill (**the CC Bill EM**), the Amendment Bills are intended to achieve the following three broad policy objectives:¹

- amend the superfast network rules in Parts 7 and 8 of the Telecommunications Act 1997 (**Telco Act**) to make the default structural separation requirement clearer and more effective as a baseline for industry, while at the same time creating new commercial and competitive opportunities;
- introduce a statutory infrastructure provider regime; and
- introduce a funding mechanism for regional broadband services.

The funding mechanism referred to in the third objective above relates to 'non commercial services' provided by NBN Co. These are services where the revenue from the service is less than the full cost of providing the service. High speed broadband services delivered over NBN Co's fixed wireless and satellite networks are considered to be non-commercial services.² For ease of expression these services will be referred to in this submission as **the Non Commercial Services**.

The following four policy options for funding the Non Commercial Services are considered in the RBS EM:³

- Option 1: Do nothing: under this option nbn would continue to fund net costs from its fixed wireless and satellite services through an internal cross subsidy.
- Option 2: Fund the Non Commercial services through Commonwealth budget (**Budget**) funding.
- Option 3: The Regional Broadband Scheme (**RBS**) as proposed in the RBS Bill.
- Option 4: Targeted post-market subsidies funded from the Budget.⁴

As part of its inquiry into the Amendment Bills, the Senate Committee has invited submissions about the Amendment Bills from interested parties.

Vocus Group Limited (**Vocus**) is one of the 'big four' telcos in Australia. In addition to the Vocus brand, the Vocus group includes the following brands: Commander, iPrimus, Dodo, Engin, M2 Wholesale and Amnet

¹ The Parliament of The Commonwealth of Australia House of Representatives Telecommunications Legislation Amendment (Competition and Consumer) Bill 2017 Explanatory Memorandum, at p.2.

² The Parliament of The Commonwealth of Australia House of Representatives Telecommunications Legislation (Regional Broadband Scheme) Bill 2017 Explanatory Memorandum (**RBS EM**), at p.6.

³ ibid, at pp 12-13.

⁴ As the funding for this option would be from the Budget, this could be categorised as a variant to Option 2.

Broadband. As an active competitor in telecommunications markets in Australia, Vocus is directly affected by, and has an interest in, the subject matter of this inquiry. Vocus therefore welcomes the opportunity to provide a submission to the Senate Committee.

2 Overview and structure of this submission

Vocus submits that:

- As regards the CC Bill:
 - Reform of Parts 7 and 8 of the Telco Act is justified. The change to the scope of Part 8 of the Telco Act is appropriate and sensible. This issue is discussed in section 3 below.
- As regards the RBS Bill:
 - The most appropriate way to fund the Non Commercial Services is through Budget funding (i.e. Option 2). This issue is discussed in section 4 below.
 - Option 3 is not the best option because it gives rise to unnecessary risk and uncertainty. This issue is discussed in section 5 below.
 - The risk and uncertainty arising under Option 3 can be avoided by having a levy that has a broad rather than a narrow funding base. In particular, any levy should be technologically neutral, with mobile, fixed wireless and satellite networks included within the levy. This issue is discussed in section 6 below.
 - The justification for applying the RBS to business services is weak and contrary to the approach taken to identify which networks that compete with the NBN should be subject to level playing field regulation. This issue is discussed in section 7 below.
 - Consideration of how to recover the costs of the Non Commercial Services should not take place in isolation from consideration of the Universal Service Obligation (**USO**). This issue is discussed in section 8 below.

In light of the above submissions on the RBS Bill, Vocus' overall message on the RBS Bill is that the RBS should not proceed in its current form. In order of preference, Vocus submits the following alternative actions should occur:

- the costs of the NBN fixed wireless and satellite networks should be written down, thus avoiding the need to recover the initial capital costs of the Non Commercial Services; or
- the costs of the Non Commercial Services⁵ should be recovered through an industry levy applied to a broad funding base. The scope and design of the levy should be considered in conjunction with the requirements of, and learnings from, the USO; or
- refinements should be made to the funding base of the RBS (as discussed in section 7 below), so that regulation of superfast networks is applied in a consistent manner.

⁵ Note that for ease of expression a reference in this submission to the 'costs of the Non Commercial Services' is to the costs of those services that cannot reasonably be recovered through service charges to end users of those services.

3 The change to the scope of Part 8 of the Telco Act is appropriate and sensible

From Vocus' perspective, one of the biggest practical problems that arises from Part 8 of the Telco Act in its current form is the potential for it to capture networks that have been constructed for the purpose of servicing business customers, and which only service business customers (for ease of expression referred to as **Business Networks**).⁶ As has been recognised in the CC Bill EM, market dynamics for residential and small business services are different and there is greater scope for competition in the market for small business services.⁷

Given that the market dynamics for residential services and the market dynamics for small business services are different, applying regulation to a combined market for residential and small business customers is bad in principle. Furthermore, undertaking an exercise to determine whether a customer is a small business or not a small business is uncommercial (i.e. there is no commercial reason for doing this), and any assessment made is only valid at the time it is done – i.e. at the start of the life of a service the customer could be a small business but the business may grow during the life of the service and the business may no longer be a small business. Therefore, in addition to the fact that merging the markets for residential and small business services is bad in principle, there are significant practical problems that arise from seeking to apply regulation to a combined residential and small business market.

Vocus submits that the following is the more appropriate dichotomy which reflects commercial reality:

- the market for superfast residential broadband services; and
- the market for superfast business broadband services.

As regards whether Part 8 of the Telco Act should apply in both of these markets, it has been well established that Part 8 of the Telco Act should have no part to play in regulating networks that are used to supply services to business customers that are not small business customers.⁸ Therefore, as a matter of principle, it would not be appropriate to apply Part 8 to such networks. Given that such networks are likely to also be used to supply services to small businesses, and the practical difficulties involved in distinguishing between businesses that are small businesses and businesses that are not small businesses, Vocus submits that the appropriate approach is to exclude such networks from Part 8 of the Telco Act.

In light of the above, Vocus welcomes, and strongly supports, the proposed changes to Part 8 of the Telco Act which would have the effect of capturing only local access lines used to supply superfast carriage services to residential customers. Proceeding in this way appropriately acknowledges the relevant market dynamics and commercial realities. Therefore, Vocus submits that this is an appropriate and sensible change.

4 The most appropriate way to fund the Non Commercial Services is through Budget funding

At the outset, it is important to keep in mind the fact that the tax payer equity funding for the building of the NBN has already been decided. Therefore, strictly speaking, the Non Commercial Services are already subject

⁶ Or the extent to which residential customers are serviced is incidental.

⁷ CC Bill EM, at p.31.

⁸ See for example: Independent cost-benefit analysis of broadband and review of regulation Volume I – National Broadband Network Market and Regulatory Report, at p. 74. Furthermore, ACCC merger assessments in the telecommunications industry do not tend to treat residential and small business as one market – see for example: ACCC, Statement of Issues 11 June 2015 TPG Telecom Limited – proposed acquisition of iiNet Limited – in which consideration of the proposed merger between two of the top five broadband service providers was considered in the context of residential markets and wholesale markets.

to Budget funding and the pertinent question that arises is not whether they should be subject to Budget funding (because this has already occurred) but:

Should the costs of providing the Non Commercial Services be fully recovered, and, if so, how?

For ease of expression, this question will be referred to as **the Fundamental Question**.

If the answer to the first part of the Fundamental Question is ‘no’ then it would be appropriate to write-down the value of the relevant assets. It should be noted that the Vertigan Review Panel expressed the following view on this issue:⁹

In the panel’s view, such write-downs have the merit of recognising immediately the future losses the project will impose on the community and are therefore consistent with sound public sector practice. Indeed, to the extent to which the NBN project as a whole is unlikely to recover its appropriately measured cost of capital, the panel believes it is incumbent on the Government to recognise that fact and its fiscal consequences promptly, and urges it to do so.

Vocus believes that there will need to be strong justifications to depart from ‘sound public sector practice’. No such justifications are apparent to Vocus. Therefore, Vocus considers Option 2 to be the most appropriate option.

5 The uncertainty and risk arising from Option 3

Vocus acknowledges that the RBS EM identifies a number of advantages and disadvantages with each of the options considered, and it attempts to identify and articulate the extent of the net benefit of each option, and in doing so, concludes that Option 3 has the highest net benefit. However, Vocus submits that this analysis does not give sufficient consideration and weight to the significant risk and uncertainty arising from the RBS in its current form, as compared to a levy that has a broader funding base. Vocus submits that when this risk and uncertainty is specifically considered, it becomes clear that the RBS in its current form is not the best option.

The rationale for Option 3 as expressed in the RBS EM is as follows:¹⁰

Under the Scheme, the opaque cross subsidies currently embedded in nbn’s wholesale prices will be replaced by transparent funding provided via contributions sourced from all owners of high-speed broadband access networks—i.e. nbn and networks comparable to the nbn. The proposed funding arrangement does not represent a new cost for the industry—or consumers—as a whole as the cost of the fixed wireless and satellite networks is already being recovered by nbn, it would simply mean that the distribution of the cost would now extend to fixed line networks competing with nbn.

Or to put it another way, Option 3 involves answering the Fundamental Question as follows:

The costs of the Non Commercial Services should be recovered from the service charges for NBN commercial services and the services charges for commercial services provided on fixed line networks competing with the NBN.

Restricting the RBS to the NBN and fixed line networks competing with the NBN involves a risk that the costs of the Non Commercial Services may not be able to be fully recovered if changes to market conditions mean that NBN Co and its fixed line competitors no longer have sufficient market share to absorb all of the costs of the Non Commercial Services. For ease of expression this risk will be referred to as **the Market Change Risk**.

⁹ ibid, at p.104.

¹⁰ RBS EM, at p.23.

Any market assessment is limited to the circumstances in existence at the time the assessment is made, and, therefore, the extent to which a market assessment remains valid depends on the extent to which circumstances remain the same. In this regard, Vocus notes that the market assessment in the RBS EM has concluded that mobile carriers are not competitors of NBN Co, and therefore should not be included in the RBS. This conclusion was reached on the basis that:¹¹

As part of its 2015 Superfast Broadband Access Service (SBAS) declaration inquiry, the ACCC found in its final report that while mobile broadband may be a substitute for high speed broadband services for some customers, this is not generally the case because of the functional differences between the services. For example, mobile networks may not support data intensive applications and that there appears to be a substantial difference in the data allowances and per gigabyte pricing between mobile and fixed line broadband services.

For example, the ACCC found that high speed fixed line broadband services are typically around the 25/5 Mbps level with monthly download limits of around 100GB. One such offer from Exetel costs \$50 per month on a 12-months contract. In contrast, one of the latest large mobile offerings from Optus with a month download limit of 50 GB²⁹ costs \$70 per month on a 24-months contract.

[...]

Given this disparity of pricing and capacity, the ACCC's draft SBAS decision found that it is unlikely that customers would substitute mobile broadband services in the event of a small but significant non-transitory increase in price in the provision of superfast broadband services.

Vocus submits that, given the trajectory of the development of mobile technology, it is reasonably foreseeable that, if not already,¹²at some point in the near to medium term (i.e. within the next three years) there will be mobile broadband service offerings that are entirely substitutable for the bulk of the fixed line broadband services that are offered on the NBN. This is already possible with 4G networks but will become inevitable with 5G networks. Telstra has already announced plans to introduce 5G services in Australia. According to a Telstra statement in January 2017:¹³

A decade ago gigabit-class speeds on mobile networks could scarcely be imagined. From next month they become reality when we introduce the Telstra Nighthawk M1 mobile broadband hotspot which is the fastest mobile device in the world. It's going [sic] help people further embrace a new breed of mobile applications and experiences including immersive virtual reality, connected cloud computing and rich entertainment. And it brings us one step closer to introducing 5G in Australia.

Fixed wireless networks also give rise to the Market Share Risk, as the following statement from BigAir demonstrates:¹⁴

Connect better than ever before with Australia's leading Fixed Wireless Ethernet network for business. Our network delivers carrier-grade, high-availability, symmetrical broadband performance, with speeds up to 1Gbps and the agility of the air.

¹¹ ibid, at pp. 26-27.

¹² Noting that the ACCC market assessment referred to in the RBS EM is over two years old.

¹³ <https://exchange.telstra.com.au/one-step-closer-to-5g-with-gigabit-speeds/>

¹⁴ <http://www.bigair.com.au/fixed-wireless-ethernet>

6 The risk and uncertainty arising under Option 3 can be avoided by having a levy that has a broad rather than a narrow funding base

In terms of mitigating the Market Change Risk, the RBS EM states:¹⁵

The legislation includes a requirement for a statutory policy review of the Scheme by the Department of Communications and the Arts within the first four years of the Scheme or as soon as practicable. If mobile broadband become increasingly substitutable for fixed line high speed broadband then the Department could initiate a review of the legislative arrangements.

Vocus submits that such an approach is not attractive. A more effective way to deal with the Market Change Risk is to have a broad funding base across the industry. If a broad funding base is used from the outset, there will be no need for any regulatory resets to that funding base and the uncertainty and risk discussed in section 5 above goes away. Essentially, when considering the regulatory approach to recovering the costs of the Non Commercial Services, the Government has a choice between:

- Implementing cost recovery of the Non Commercial Services with a narrow funding base so that costs are only recovered from NBN Co and its fixed line competitors. Such an approach cannot be done on a 'set and forget' basis and will require periodic revision to ensure that any changes in the market are taken into account (**the Narrow Approach**).
- Implementing cost recovery of the Non Commercial Services so that costs are recovered from a broad industry funding base. The funding base can be set on a 'set and forget' basis (**the Wide Approach**).

On the basis of regulatory practice that aims to achieve efficient and certain regulation, and which seeks to reduce market distortions,¹⁶ the Wide Approach is clearly the better approach over the long term.

Vocus notes the following justification for the Narrow Approach has been included in the RBS EM:¹⁷

While the precise difference in net benefits between this option [i.e. Option 3] and the others are not able to be measured, both the BCAR and the ACCC noted that nbn would face greater incentives for cost efficiency if the costs for providing its fixed wireless and satellite networks were mainly borne by nbn itself. The BCAR also recommended a charge on fixed line broadband providers on the basis that the benefits in productive and dynamic efficiency from ensuring costs were mainly borne by nbn itself outweighed the lower allocative efficiency from a narrower charge. These arguments favour Option 3 (Regional Broadband Scheme) as the option with the highest net benefit, although there are some uncertainties about the potential magnitude of the different impacts of these options.

Vocus submits that this justification is weak and should not outweigh the obvious advantages of the Wide Approach. Whether NBN Co pays the bulk of the levy is not prescribed under the RBS and is dependent on market conditions. As discussed above, there are real risks that the market assessment that has been used to support the Narrow Approach will soon be, if it is not already, obsolete. Furthermore, there are other ways of ensuring that NBN Co keeps the cost of the Non Commercial Services down - regulation being the obvious, more certain and effective, way to do this.

¹⁵ RBS EM at p.27.

¹⁶ It is not controversial to state, and is acknowledged in the RBS EM, that the larger the funding base the less potential there is for market distortions – RBS EM, at p.13.

¹⁷ RBS EM, at p.23.

7 **The justification for applying the RBS to business services is weak and contrary to the approach taken to identify which networks that compete with the NBN should be subject to level playing field regulation**

It is clear that the regulatory mechanism that is intended to provide NBN Co with a levy playing field is Part 7 and Part 8 of the Telco Act. As noted in the CC Bill EM:¹⁸

The Explanatory Memorandum to the Telecommunications Legislation Amendment (National Broadband Network—Access Arrangements) Bill, which introduced Parts 7 and 8 into Parliament, noted the scope for competing providers to target highly profitable areas and “operate as vertically-integrated providers and advantage themselves over independent retail service providers.”

Parts 7 and 8 were intended to ensure that where such networks are built and operated that they provide consumers with a choice of competing retail service providers and the benefits of that competition, in terms of service innovation and lower retail prices. As such, they seek to provide consumers with the same types of outcomes that they should enjoy on the NBN. They also meant that retail providers in the residential and small business markets would have limited opportunities to operate their own access networks going forward, advantaging their retail businesses as a result.

As regards the application of this regulation to Business Networks, as discussed in section 3 above, there are strong reasons why:

- the level playing field regulation should not apply to Business networks; and
- why NBN level playing field regulation should not create a dichotomy between small business customers and business customers that are not small businesses.

In light of this, Vocus is somewhat dismayed at the prospect of the RBS being applied to Business networks. The reasoning process that has led to the RBS being applied to such networks is articulated as follows in the RBS EM (emphasis added):¹⁹

The BCAR also considered an exemption for networks serving medium and large businesses. In its final report, the BCAR noted that the nbn was competing for business in the medium and large business markets. On this basis the BCAR noted that “it seems reasonable that nbn should contest these markets on a level playing field basis, suggesting grounds for introducing funding arrangements that ensure equal contributions towards NBN non-commercial services”. At the same time, the BCAR noted that including networks servicing medium and large businesses would expand the charge base and improve allocative efficiency outcomes. Against this, the BCAR considered the policy rationale of the existing Parts 7 and 8 of the Telecommunications Act 1997, noting that the provisions in these parts do not extend to networks serving medium and large businesses because infrastructure competition generally exists in these markets. Further, the BCAR noted that while access lines to medium and large businesses were potentially high value, they are expected to be relatively small in number compared to lines serving residential and small business customers. Consequently, on balance the BCAR favoured excluding networks servicing medium and large business customers.

Since the BCAR’s final report a number of other issues have come to light. In particular:

¹⁸ CC Bill EM, at p.29.

¹⁹ RBS EM, at p.29.

- nbn has increasingly sought to expand its network to service medium and large businesses and is actively pursuing these commercial opportunities; [the First Justification]
- it is reasonable to include networks serving medium and large businesses as they are also consumers of high speed broadband [the Second Justification]; and
- there are compliance costs for networks to determine whether the customers on their networks are small or medium businesses. For example—it may be difficult for a wholesale network provider to determine how many employees the customers of its retailers have. This is particularly difficult if staffing numbers fluctuate from month to month [the Third Justification].

On this basis, it is proposed that networks servicing medium and large businesses be included in the charge base.

Vocus submits that, in the specific context of a narrowly targeted levy to create a level playing field for NBN Co, the justifications for applying the RBS to business services are weak for the following reasons:

- As noted in section 3 above, and identified by the BCAR, the 'level playing field' regulation is contained in Parts 7 and 8 of the Telco Act. Therefore, it is only networks that are captured by that regulation that are required to compete on the same basis as NBN Co.
- The First Justification does not justify extending revised Part 8 to Business Networks. Therefore, it cannot justify applying the RBS to services provided using such networks.
- The Second Justification applies equally to fixed wireless, satellite and mobile broadband networks. However, these are not included in the RBS.
- The Third Justification is a reason why no non NBN business services (i.e. regardless of the size of the business) should be subject to the RBS (i.e. on the same basis that these services are not captured by the revised Part 8 of the Telco Act).

In light of the above, Vocus submits that if the Government decides to continue to narrowly target the RBS, the RBS should only apply to services that are subject to the revised Part 8 of the Telco Act.

8 Consideration of the cost recovery for the Non Commercial Services should not take place in isolation from consideration of the Universal Service Obligation (USO)

Recovering the costs of non commercial, but socially desirable, services by means of an industry levy is not a new concept in Australian telecommunications policy, and for many years the USO was an established and largely uncontroversial part of the landscape. However, with changes to technology, the utility of the USO has been put seriously in doubt. Indeed, in a recent inquiry into the USO by the Productivity Commission, the Productivity Commission concluded that the USO is anachronistic and costly and should be wound up by 2020.²⁰

The Productivity Commission also opined that:²¹

²⁰ Telecommunications Universal Service Obligation Productivity Commission Inquiry Report, No.83, 28 April 2017, at p.2.

²¹ ibid.

The current pattern of disparate and siloed policy reviews and proposed legislative reform raises concerns about the coherence of policies to address universal service objectives and must be carefully managed and coordinated.

Given that the USO and the RSB have the same basic policy objectives, and the need for coherent and holistic regulatory policy in this area, as part of its inquiry, the Productivity Commission considered the RBS. Vocus notes that the Productivity Commission was not in favour of the RBS being considered in isolation from the USO reforms and was not in favour of the Narrow Approach for the RBS. In the words of the Productivity Commission itself:²²

The funding of nbn's non-commercial services should, moreover, not be considered independently of universal service policy reforms. In this context, the Commission has faced a unique challenge in responding to proposed government policy on the funding of nbn non-commercial services (the Regional Broadband Scheme) before the conclusion of this inquiry.

The Regional Broadband Scheme is proposed to (at least initially) include only a narrow levy base. In principle, the choice of funding model for non-commercial services should seek to minimise distortions in the telecommunications market, the risk of which is heightened with a narrowly-based long-term industry levy. As such, the Government may need to revisit the merits of alternative funding arrangements for nbn's non-commercial services.

Vocus submits that the conclusions of the Productivity Commission support the view that there is a compelling reason for a more holistic approach to be taken to the issue of cost recovery of Non Commercial Services. Vocus believes that any delay to the implementation of the levy arrangements for the Non Commercial Services that will arise from considering the issue together with the USO will not have any material adverse consequences in terms of cost recovery because NBN Co currently charges prices at a level that includes a cross subsidy of the Non Commercial Services. As pointed out in the RBS EM:²³

The proposed funding arrangement does not represent a new cost for the industry—or consumers—as a whole as the cost of the fixed wireless and satellite networks is already being recovered by nbn, it would simply mean that the distribution of the cost would now extend to fixed line networks competing with nbn.

9 Contact information

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²² ibid at pp. 16-17.

²³ RBS EM, at p.23.