Submission No. 10

Australian Government

Department of Broadband, Communications and the Digital Economy

Peter Harris

Secretary

Mr Robert Oakeshott MP
Chair
Joint Committee on the National Broadband Network
PO Box 6022
Parliament House
CANBERRA ACT 2600

Dear Mr Oakeshott Rob

Review of the Rollout of the National Broadband Network - Submission from the Department of Broadband, Communications and the Digital Economy

Thank you for your letter dated 5 March 2012 inviting submissions from the Department of Broadband, Communications and the Digital Economy on Telstra workforce issues and private equity funding to inform the Committee's third review of the rollout of the National Broadband Network (NBN).

I am pleased to enclose the department's consolidated submission to this review. The department looks forward to elaborating on the matters outlined in the submission at the Committee's next hearing.

Yours sincerely

Peter Harris
2 April 2012

38 Sydney Avenue, Forrest, Canberra ACT 2603 Australia • telephone 02 6271 1872 • facsimile 02 6271 1077
website http://www.dbcde.gov.au

Australian Government

Department of Broadband, Communications
and the Digital Economy

Submission to the Joint Committee on the National Broadband Network

Third Review of the Rollout of the National Broadband Network

April 2012

Submission to the Joint Committee on the National Broadband Network Third, Six-Monthly Review of the Rollout of the National Broadband Network

Introduction

The Australian Government understands that access to affordable, high-speed broadband is increasingly essential to the way Australians communicate and do business. It will help drive productivity, improve education and health service delivery and connect our cities and regional centres.

The Australian Government has established NBN Co Limited (NBN Co) to design, build and operate a new high-speed National Broadband Network (NBN). The NBN will be the single largest infrastructure investment made by an Australian Government and will be accompanied by historic reforms to the telecommunications sector. The NBN is about more than having a faster internet connection. The productivity gains associated with this investment will mean that the full benefits will continue to flow for decades beyond the completion of the project.

NBN Co's central objectives, as set out by the government are to:

- deliver significant improvements in broadband service quality to all Australians;
- address the lack of high-speed broadband in Australia, particularly outside metropolitan areas; and
- reshape the telecommunications sector.

The NBN will provide access to high-speed broadband to 100 per cent of Australian premises. It will connect 93 per cent of homes, schools and businesses to a high-speed fibre network capable of providing broadband speeds of up to one gigabit per second (Gbps). Seven per cent of premises will be served by a combination of next-generation fixed wireless and satellite technologies providing peak speeds of 12 megabits per second (Mbps).

The NBN will be Australia's first national wholesale-only, open access broadband network offering equivalent terms and conditions to all access seekers or service providers. NBN Co will roll out the network and sell wholesale services to retail service providers. In turn retail service providers will offer retail services to consumers. This is a significant structural change to Australia's telecommunications industry, aimed at encouraging vibrant retail competition.

On 7 March 2012 the Definitive Agreements between NBN Co and Telstra came into force. The Agreements pave the way for a faster, cheaper and more efficient rollout of the NBN. They include the reuse of suitable Telstra infrastructure, avoiding infrastructure duplication and for Telstra to progressively structurally separate by decommissioning its copper network during the NBN rollout. In support of the NBN and the Definitive Agreements, in June 2010 the government made commitments on a package of important measures including the Commonwealth and Telstra $100 million Retraining Funding Deed which will provide Telstra with funding to assist in the retraining and deployment of Telstra staff affected by these reforms.

Telstra Retraining Funding Deed

The Joint Committee on the National Broadband Network has requested a submission from the Department of Broadband Communications and the Digital Economy ('the department') on Telstra workforce issues including:

- "Composition of Telstra's workforce
- Terms and conditions of the Retraining Funding Deed and what this will mean in regard to the type of, and timing of and training available for existing, retrenched and migrated (to NBN Co) Telstra employees
- Timing of lodgement of Telstra's training plan
- Government's involvement in the recruitment of overseas Telstra employees
- The level and value of employment to be created through the building and operation of the NBN
- Incentives for Telstra to continue to recruit new staff nationally".

Terms and conditions of the Retraining Funding Deed

The Retraining Funding Deed (the Deed) came into force when the Definitive Agreements commenced on 7 March 2012.

The objectives of the Deed between the Commonwealth and Telstra are:

(i) To support the availability of an appropriately trained workforce for the NBN; and

(ii) For Telstra to establish a retraining arrangement for its staff who may otherwise have faced a redundancy as a consequence of the rollout of the NBN, thereby creating greater value for Telstra as part of the overall Definitive Agreements package than the Commonwealth's cash contribution.

Eligible Employees

The Deed sets out how Telstra will identify employees that are eligible for retraining, the scope of training courses to be made available, the standards and quality that must be met, and timing of training.

The Deed operates by identifying an "Automatically Eligible Workgroup" (AEW) and which other employees may be determined to be eligible. The AEW group will have priority for accessing the retraining. The AEW group includes Telstra's:

- copper and hybrid fibre coaxial (HFC)–based field workforce which undertakes installation and maintenance and construction and maintenance activity on Telstra's Customer Access Network;

- direct field support workforce which conducts copper/HFC based field workforce support, including workforce management, workforce and resource planning, and construction program management;

- support of copper/HFC operations workforce which provides design of projects, management of damages, network integrity, plant assigning, customer network improvements and contract management; and
- wholesale copper service workforce which provides the interface between retail service providers and Telstra in relation to copper services.

The remaining eligible employees will be those employees or a class of employees who may face redundancy unless retrained for redeployment as a consequence of the decommissioning of the copper network and the HFC network broadband capability being deactivated.

Telstra has advised the number of employees in the AEWs as at 1 March 2012 was 6255 employees.

Training Plan

Telstra will submit a draft training plan to the Commonwealth by 30 April 2012 for approval. The training plan will cover a three year period (financial years). The scope of the training plan is to identify the training needs, courses to be developed, approach to course development, training methodology and targets for retraining. Telstra will give priority to retraining in NBN-related technical, process and system activities. Occupational Health & Safety requirements relevant to the retraining must be embedded in each relevant training course.

The training plan must meet the requirements of the Deed, which include that it must use 70 per cent of the funds for Accredited Training, to be delivered by a Registered Training Organisation (RTO). An RTO must be registered with a State or Territory training authority of the National Audit and Registration Agency. This is an important quality measure in the Deed. This means Telstra staff will be building on their skills and experience with accredited training that can be used towards the achievement of nationally recognised qualifications.

Another important aspect under the Deed is that Telstra has prepared a Stakeholder Management Plan which identifies employees and unions as key stakeholders. Telstra will meet quarterly to discuss the retraining with unions and will consult with its unions on the Training Plan Outline. Telstra must genuinely consider any matters raised by the unions. A representative from the department will attend those meetings as an observer. Consultation meetings with the unions have already occurred, on 4 November 2011 and 19 March 2012.

Key audit and reporting obligations under the Deed include that Telstra must create and maintain full and accurate accounts and records of the conduct of the retraining, the use of funds, progress against the training targets and training plan, and the creation, acquisition and disposal of assets. Telstra will provide an annual budget and provide an audited annual financial report against it.

The initial draft training plan must be lodged by 30 April 2012, and subsequent plans to be lodged six months before the expiry of the previous plan. The term of the Deed is for eight years and Telstra may request an extension of a further three years.

Incentives for Telstra to continue to recruit new staff nationally

The department has no basis on which to advise the Committee on this issue and has sought advice from Telstra.

Telstra has advised that:

> *"Telstra is committed to recruiting and retaining the best talent and is one of Australia's largest employers. Telstra does not have any policy to recruit overseas workers. However, Telstra continually reviews its business to determine how best it can serve its customers. This means that we may work with other companies in the telecommunications industry to leverage their expertise while we focus more on our core business. From time to time this means that we restructure the business and this can result in roles becoming redundant.*
>
> *Where roles have been made redundant as a result of a restructure, significant effort is made to reassign or redeploy affected employees to suitable roles across Telstra.*
>
> *In recent restructures, employees are able choose to go into a redeployment pool. We have made considerable efforts to increase the number of employees who we redeploy and our redeployment rate has increased significantly to around 40% of staff that want to be redeployed.*
>
> *The objectives of the Retraining Funding Deed include that Telstra retrain employees who may otherwise have faced redundancy as a result of the NBN rollout. As the focus of the Deed is on retraining, Telstra is committed to delivering on its obligations to prepare its existing employees to work on the NBN".*

The Australian Government has no role in Telstra's recruitment practices.

Composition of Telstra workforce

The department sought and received the following information from Telstra:

		Full Time Equivalent Employees
(1)	**Telstra-paid Employees**	**28,853**
	Domestic Controlled Entities	4,089
(2)	**Domestic Employees:** (1) + Domestic Controlled Entities	**32,942**
	Offshore Controlled Entities	4,219
(3)	**Total Employees:** (2) + Offshore Controlled Entities	**37,161**
	Agency + Contract Labour	4,711
(4)	**Total Workforce:** (3) + Agency + Contract Labour	**41,872**

As at 31 December 2012 (Total workforce includes those employees on Long Term Extended leave)

Note: of the Telstra Paid Employees (1) – 15,257 FTE are in Operations, 8,625 FTE are in Customer Sales and Service and the remaining 4,971 FTE are in Corporate Areas (including Marketing and Products, Finance, HR, Business Support & International).

The level and value of employment to be created through the building and operation of the NBN

The NBN represents the single largest infrastructure investment ever made by an Australian Government, and is part of a broader package of historic reforms to the telecommunications sector.

Initial estimates prepared by the Australian Government in developing the NBN policy announced on 7 April 2009 indicated that the NBN would support up to 25,000 local jobs every year, on average, over the life of the project, with up to 37,000 jobs at its peak. These figures relate to the broad economic impact (i.e. an economy-wide impact) of the government's decision to invest in the NBN policy and included the jobs created in related sectors that have all started gearing up to support or deliver services over the NBN.

NBN Co has since established a workforce development group which has undertaken a detailed assessment of the tasks involved in the rollout, the skills required and the corresponding demand and supply for employment during the rollout construction.

NBN Co has forecast direct employment demand for total employment in the construction phase of 16,000 to 18,000 jobs at peak of construction. There are five key roles which make up around 80 per cent of forecast workforce demand:

- Labourer (5,500)
- Earthmoving Plant Operator (2,300)
- Road Traffic Controller (900)
- Cabler (3,000)
- Telecommunications Lineworker (1,100)

One of the key elements of NBN Co's job requirements is that the rollout of the NBN is dispersed across Australia, providing real opportunities for local employment, particularly during the construction phases. Importantly, NBN Co's analysis for the construction task has found there are enough people in the industry to meet the skills requirements for the construction of the network. This means the construction of the NBN should not contribute to skills shortages.

Other than the construction task, jobs will be created through direct NBN Co employment, through NBN Co's purchase of inputs for the rollout and related companies and industries gearing up to deliver applications and services over the NBN infrastructure and the flow-on effects to the businesses these firms interact with.

As at 26 March 2012, NBN Co had 1,496 employees and is planning to employ up to 2,800 employees during the peak of the rollout.

A significant amount of job creation is happening with firms supplying key inputs for the rollout to NBN Co. The company has a range of contracts to obtain specialised services, extending the value of the NBN to Australian industry. During 2011, NBN Co awarded a range of contracts with a total value of almost $4 billion the majority of which was for Australian-based manufacturing and services, leading to direct new employment of approximately 700 to 1000 new jobs.

While ultimately all procurement policies are a commercial matter for NBN Co, the Statement of Expectations issued on 17 December 2010 stated the Government expects NBN Co will actively promote opportunities, where possible, for local enterprises. NBN Co seeks local content and sourcing arrangements in its major contracts, particularly where there is known local supply capacity or the potential to promote additional local production through NBN Co contracts.

An example contract was $300 million to Prysmian, a global manufacturer of cabling with manufacturing facilities in Dee Why and Liverpool, NSW. Prysmian CEO Lyall Roberts estimated that in addition to 50 direct new jobs in Dee Why, the flow-on effect of NBN contracts would be 2:1 with the extra jobs created in transport, logistics, training, administration and other support roles.

Corning Cable Systems which was awarded an equipment contract with NBN Co is expected to add 300 to 400 new staff over the next couple of years as a result of its NBN deal.

The NBN has also stimulated job growth in the research and development sector.

The Institute for a Broadband Enabled Society, a cross-disciplinary research institute dedicated to products, services, and innovations that maximize the benefit of new broadband technologies to Australian society, was established in 2009 in the wake of the NBN announcement.

This institute grants PhD scholarships and employs researchers such that in 2010-11, 169 Melbourne University researchers and 46 external collaborators contributed to the institute's research.

In addition, the successful rollout of the $250 million Regional Backbone Blackspots Program (RBBP), the first building blocks of the NBN on mainland Australia was completed by Nextgen Networks in December 2011. Since the RBBP was launched in February 2010, it took just under two years to design, rollout, commission and test almost 6,000 kilometres of fibre optic cable.

Over 80 per cent of the $250 million of project funding was directed towards Australian companies. From the outset, Nextgen expected the investment to create more than 1,000 full time equivalent jobs and provide economic stimulus to regional locations including:

- setting up a new project office in Melbourne (around 100 employees);
- injecting $30 million into material procurement in Victoria and South Australia for equipment shelters and optical fibre cable;
- the creation of 16 jobs by an optic fibre cable supplier to the project; and
- the thousands of nights of accommodation and thousands of meals served up in regional Australia in deploying the project.

The NBN is key nation-building infrastructure and the rollout is creating thousands of new job opportunities across the country.

Private Equity Funding

The department was requested by the Chair of the Committee to make a submission in relation to Private Equity Funding. The specific issues to be covered were:

"Within the existing legislative framework:

- Bringing forward the timeframe for private equity engagement in funding the NBN.
- The cost/benefit of bringing forward the timeframe for private equity engagement in the NBN.
- Gauging investor interest in the NBN.
- Possible incentives to attract private investment in construction of the NBN.
- Retrospective cost/benefit of different ownership structures."

This submission by the department outlines the existing legislative framework under which NBN Co has been established, sets out the policy rationale for the development of that framework and discusses the issues that may arise and their policy implications for the most accessible means for bringing forward private equity engagement.

Existing Legislative Framework

NBN Co was established as a company under the *Corporations Act 2001* in April 2009 and is governed by the provisions of that Act. In addition, as a company whose shares are owned by the Australian Government, NBN Co is subject to the provisions of the *Commonwealth Authorities and Companies Act 1997*. These Acts provide the framework for the operation and governance of corporations generally and more specifically those owned by the Commonwealth.

The Parliament has in addition passed legislation specifically in relation to NBN Co and any related entities. The *National Broadband Network Companies Act 2011* sets out the circumstances in which the Commonwealth can dispose or transfer shares in NBN Co. This requires the satisfaction of a number of preconditions including:

- declaration by the Communications Minister that the national broadband network should be treated as built and fully operational
- the conduct of a Productivity Commission inquiry into the regulatory framework for the network, impacts of a sale of the Commonwealth's equity on the budget and the supply of broadband services and the impact on competition in the telecommunications market
- conduct of a parliamentary Joint Committee consideration of the Productivity Commission report
- declaration by the Finance Minister that conditions are suitable for the conduct of a sale
- expiry of a fifteen sitting day disallowance period without either House passing a resolution of disallowance.

Following satisfaction of all these preconditions a sale of NBN Co can proceed.

These provisions cover sale or transfer of shares in NBN Co, separately there are provisions placing restrictions on the nature of capital that can be applied in NBN Co. These preclude a party other than the Commonwealth being able to exercise all the voting rights, holding any of the paid up share capital of NBN Co or holding any of the rights to any distribution of capital or profits.

Policy Rationale

The government embarked on the NBN initiative following the failure of the market to provide high speed broadband at affordable prices to all areas of Australia. Private equity had not been willing to make the necessary investments.

The government sought detailed advice from McKinsey and KPMG in the Implementation Study on the opportunities to attract private investment to the NBN.

The detailed analysis, which included extensive discussions with the providers of private investment, identified a number of key factors affecting the use of private investment including:

- amount available for investment
- returns required on investment
- level of control required by investor.

Investment amounts – while Australian superannuation funds have very substantial funds available for investment, these are subject to quite rigid asset allocation regimes involving a heavy focus on diversification of exposure between types of investment and within investment types, between individual investments. The size of individual investments is strongly biased towards low risk where returns are highly predictable and high levels of confidence are held for retention of capital value. For stable low risk investments, amounts in the hundreds of millions can be available, for higher risk the amounts are in the tens of millions or less depending on the state of development. Despite government sponsorship the NBN would be considered high risk for commercial finance sources because of project implementation risk and concerns about the telecommunications policy objectives driving the project.

Returns required – the required returns are highly sensitive to the state of development of the investment. Early stage investments require returns in the range 15-25 per cent (returns at the lower end of this range are more typical of strong economic conditions, when the perceived risk to the investment from an economic downturn is lower). As an investment develops and planned targets are achieved the risk premium will reduce. For the NBN this will involve completion of the initial rollout, planned construction costs being achieved, services being taken up at the projected rates, data utilisation increasing consistent with historic trends and the regulatory framework for operation being locked in following the Productivity Commission review set out in the NBN legislation. When all those conditions have been satisfied, the returns required reduce to the 8-10 per cent range. In short, in the period of the rollout private share investment would be the most expensive source of finance, achievable only through reduced returns on the public investment or major policy compromises.

Level of control – in making investments the private sector assumes risk, which it would require mechanisms to mitigate. These could include varying levels of control of management or in the absence of that, mechanisms that limit the flexibility of those that do have control. In the case of NBN Co which has been established by government for the purpose of achieving important social and economic policy objectives (for example, national uniform pricing), judgements taken in the course of the roll-out in response to changes of circumstance or policy could be in conflict with the less complex commercial instincts of investors.

Options for Private Equity

Typically equity is considered to be share capital in a company, which is consistent with the Macquarie Dictionary definition "the interest of a shareholder of common stock in a company". A broader definition is also provided by the Macquarie "those funds of a company which are raised by borrowing from proprietors and external sources."

The introduction of any non-Commonwealth direct interest in the share capital of NBN Co would be inconsistent with the existing legislative provisions and social policy objectives set out above. The Government does not intend to sell the network or take on private equity other than in the circumstances outlined in the relevant legislation. Borrowings on the other hand are not precluded by the legislative framework. Indeed the Government's Statement of Expectations specifies that NBN Co should seek to raise debt capital at the earliest opportunity it is able without external support.

NBN Co's Corporate Plan 2011-13 plans for the introduction of debt financing mid way through the rollout, that is commencing in 2015. This plan, which is supported by the independent analysis of Greenhill Caliburn and KPMG, is based on this timing being the earliest, that the revenue generated by NBN Co would provide lenders with confidence that interest charges can be met and the borrowings repaid at the expiration of the term. The ability of NBN Co to successfully raise debt on its own behalf would be a strong demonstration of confidence in the network by private capital markets.

Conclusion

Consistent with the legislative framework for the ownership of NBN Co there are very limited options for bringing forward private investment in NBN Co. The results of the analysis undertaken by McKinsey and KPMG in the NBN Implementation Study is set out in the Executive Summary to the Study report:

"Government should fund NBN Co solely with Government equity until NBN Co can raise its own investment-grade debt and pay interest from its own earnings. Private equity should not be introduced at least until the network roll-out is complete. To do so any earlier would be too expensive, in terms of the returns required by investors, and would constrain Government's ability to establish the right policy and regulatory settings. It will also lead to a substantial distraction for management around the equity transactions concerned. This applies to both cash injections and any proposals to vend in assets in return for equity.

Private investors value certainty and demand high risk premiums to compensate for perceived uncertainty in an investment business case. In the case of the NBN, this is expected to translate into private sector investors demanding returns in the early phases of NBN Co's network roll-out in the vicinity of 15 to 25 percent—well above expected project returns. To accommodate such financing, *Government would need to accept a lower return on its equity, while implicitly bearing most of the risk given its commitment to the success of the NBN.*

Beyond its high cost, private sector equity has other drawbacks during roll-out, including the restrictions it places on Government's flexibility. The certainty demanded by private investors to lower their investment risk premiums would require Government to provide certainty upfront around the regulatory and policy safeguards it intends to implement—a requirement with which it would be difficult, if not impossible for Government to comply.

With the implementation of the NBN, the industry will go through a substantial and uncertain transition. Both Government and NBN Co need flexibility to adapt and learn through the various stages of the network roll-out, customer migration and delivery of new wholesale services. Similarly, the regulatory framework must expand from primarily addressing a vertically-integrated paradigm to embrace a wholesale-only paradigm as well. To attempt to design and lock in upfront the safeguards required against the potential downsides of a natural, national monopoly in private ownership would place at risk the success of the NBN by being restrictive and inflexible. More simply, the chances of getting all these settings right at the outset would be slim.

From a purely commercial standpoint, Government is the most natural owner of the risk versus return trade-off before NBN Co reaches steady-state operations. In its start-up phase, NBN Co faces uncertainty on multiple dimensions: competitive, technical, regulatory and political. Its financial profile requires large upfront investment with revenue generated over a 40+ year period. The Implementation Study's detailed cost modelling and conservative revenue modelling shows that over this long asset life, returns are likely to exceed Government's cost of funding. However, this requires government funding of the upfront capital costs until investment-grade debt can be raised."