Dissenting Report by Coalition Members and Senators

Background: Committee Provided with Insufficient Resources for Scrutiny

Paragraph 1.47 of the Joint Committee report notes that the Shareholder Ministers wrote to the committee in early July 2011 to advise of reporting arrangements on the NBN rollout, conscious that the Committee was due to table its first six month report by the end of August. The letter stated: "We are conscious of the importance of providing the Committee with quality information to inform its deliberations, and we are not confident that we could do so on an earlier timeframe, at least for this initial report."

The unsatisfactory consequence of this delay is that in this, the first report of the Committee appointed to oversee the construction of the NBN, we are unable to provide Parliament with the most up to date information about the progress of the construction, the rate of connection not to speak of the amount of capital drawn down and expended by the NBN Co.

The Coalition notes that the context of the Committee's was that the NBN Co had already been given extraordinary exemptions from Parliamentary and Regulatory oversight. These include:

- Exemption from review by the Public Works Committee of the Parliament
- Passing of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Act 2010, which limited the ACCC's oversight of commercial agreements undertaken by the NBN.
- The lack of a cost-benefit analysis by the Productivity Commission (or any other competent agency) to rigorously examine whether the objective of

universal and affordable broadband was most cost effectively and speedily achieved by the NBN project as presently designed.

- Failure to release the full 400-page NBN Co Corporate Plan.
- Exemptions from Freedom of Information laws.[1]

The Coalition notes that in the 2011-12 financial year, the NBN Co will receive a $3.1 billion cash injection from the Australian Government, equating to more than $258 million a month[2]. The Coalition judges that the NBN Co has been given ample resources to meet reporting deadlines set by the Committee.

In paragraph 1.11 the Joint Committee Report quotes the March 2010 NBN Implementation Study's confirmation that "high speed broadband for all Australians was achievable and could be built on a financially viable basis, with affordable prices for consumers".

From the outset, the Coalition's argument with the NBN has not been over the first point of viability. Fibre to the home (FTTH) access networks of comparable size have been built in several other countries, notably the US and Japan, and such a network is feasible in Australia given sufficient resources. Rather our doubts have always been over the second and third assertions of the Implementation Study – that such a network can be financially viable, and deliver affordable prices to consumers. Neither the evidence presented to the Joint Committee nor the broader picture of the progress of the rollout visible from the activities and public announcements of NBN Co have provided much comfort on either front.

Therefore it is of particular concern that of the three policy goals noted by the Committee, the affordability of broadband services and internet access has not been materially addressed. The Coalition believes affordability should be one of the most important policy goals given that price is the biggest barrier to internet uptake in Australia. Australia's lowest income households are eight times more likely to have no internet connection at home than the highest income households.[3]

Likewise, it is of considerable concern to Coalition members of the Committee that NBN Co is seeking the power to reverse two decades of falling telecommunications and internet prices. In a recent discussion paper on its

1 An amendment passed by the Greens ensured the NBN is subject to the FOI Act with a targeted exemption to protect the confidentiality of its commercial activities. See revised Explanatory Memorandum, National Broadband Network Companies Bill 2010 and Telecommunications Legislation Amendment (National Broadband Network Measures—Access Arrangements) Bill 2010, p. 15. House of Representatives Hansard, 1 March 2011, pp1915-1917.

2 Australian Government, (2011), Budget Paper Number 1, p.7-11.

3 Telecommunications Legislation Amendment (National Broadband Network Measures—Access Arrangements) Bill 2010, p. 15. House of Representatives Hansard, 1 March 2011, pp1915-1917.

forthcoming Special Access Undertaking to the ACCC, the NBN Co has applied for the right to increase prices on most services – excluding basic ADSL-speed equivalents – by up to CPI plus five per cent per year.[4] In comparison, the price of access to Telstra's copper access network has fallen by 7 per cent each year in real terms since 2000. And figures compiled by the OECD show that between 2005 and 2010 the price of ADSL broadband in Australia fell by 69 per cent in nominal dollars.

In this context it should be stated again that the Government has repeatedly refused to undertake a cost benefit analysis of the NBN. Such an exercise would have involved a rigorous appraisal of the direct and indirect economic benefits from the project, and weighted these against the direct and indirect costs – with the former largely arising from the cost of its construction, and the latter reflecting less obvious costs such as those arising from diminished competition or from closing off the possibility of alternative technology upgrade paths.

As Mr Michael Wood, Deputy Chairman, Productivity Commission observed in evidence before the Committee:

> "As a general principle we continue to believe that cost benefit analysis is a useful tool. We also make the point that you do not actually rely exclusively on the numbers that a cost benefit analysis will produce because it is the product of many assumptions. As long as it is a transparent process of identifying the various costs and benefits and it is transparent as to the assumptions that you have made—and there are very many complex assumptions to be made in these things; they are not simple, but they are an instructive methodology—then that is a useful contributor to decision making."[5]

It should also be underscored at the outset that the direct fiscal cost of the NBN project to the Budget is far from transparent to taxpayers. Indeed, the Government equity injection appears to be explicitly structured to hide the inherent risk of the NBN project from taxpayers and investors in other telecommunications companies, in breach of the competitive neutrality principles supported by both Labor and Coalition governments until recently.

The 2011-12 Commonwealth Budget Paper note:

> "In 2011-12, it is expected that $2.7 billion of the Government's equity investment in the National Broadband Network will be financed by AIBs, through wholesale issuance of CGS as part of the AOFM's overall debt program. AIBs will not be separately

4 NBN Co, (2011), "*Introducing NBN's Special Access Undertaking*", p.23.

5 Mr Michael Wood, Deputy Chairman, Productivity Commission, Transcript of Evidence, Canberra, 17 July 2011.

identifiable from CGS, but will be reported as AIBs in the Budget statements. In addition, from 1 July 2011 the AOFM's weekly CGS tender notices will indicate that some of the proceeds of tenders may be used to finance the Government's investment in NBN Co".[6]

Rollout Delays

It should be noted that the roll-out of early release sites has already encountered significant delays.

In a press release dated 8 July 2010 Senator Stephen Conroy stated:

> "Construction in the second release locations is scheduled for the second quarter of 2011."[7] However, Senator Stephen Conroy released a subsequent release dated 3 August 2011 noting that construction would begin in nine of the 19 release sites in staggered stages, with some sites up to six months behind schedule.[8]

In addition, some of the release sites have been arbitrarily moved from seats won at the 2010 election by the Coalition into seats held by Labor, such as Aspley in northern Brisbane.

Construction on nine of the second release sites was contingent on a construction contract signed with Silcar, covering only NSW, Queensland and the ACT. There has been no construction contract signed for second release sites in the other states – Western Australia, South Australia and Victoria. The Minister still has not announced when construction will begin on 10 of the second release sites.

Construction on the second release sites in Tasmania was supposed to begin in December. In March, Senator Stephen Conroy said construction on second release sites would begin in "less than two months".[9] Recently, the NBN Co announced construction would be staggered for the second release sites, beginning in Triabunna and Sorrell in late May and not getting to South Hobart until early October, 10 months behind schedule.[10]

It should be stressed that the delays the NBN Co is experiencing have not been confined to so-called Brownfield fibre rollouts (in areas that are already built up),

6 Budget Paper Number One, (2011), p.7-15.

7 DBCDE, (2011)

8 DBCDE, (2011)

9 *Hobart Mercury*, (2011), "Concerns over NBN Stage"

10 NBN Co, (2011)

which are the most complex deployment environments it faces. The rollout in so-called Greenfield areas (where fibre is laid at the same time as new residential and commercial buildings are constructed) is also well behind schedule. The NBN Co 2011-2013 corporate plan notes on p.15 that the organization was scheduled to have passed 45,000 Greenfields premises under build-operate-transfer (BOT) contracts with private companies by mid-2011. Because of Government policy shifts, the NBN is no longer contemplating BOT contracts with private companies and has therefore not met its deployment target in Greenfields areas, despite the NBN Co Corporate Plan stating:

> "NBN Co intends to contract with third parties chosen through a procurement process to deliver FTTP solutions in all Broadacre developments and Infill developments involving more than 100 premises. NBN Co will be able to generate revenue from these Build-Operate-Transfer (BOT) networks as soon as the transfer payment is made and will count them as 'BOT' activations."[11]

There is also considerable doubt as to the NBN's organizational capability to meet requests for installation of FTTH facilities in Greenfields areas. It was projected to have passed 127,000 Greenfields premises by June 2012. However, NBN Co CEO Mike Quigley told the Committee the NBN Co would be able to pass only 43 per cent of orders placed by developers:

> "Since 1 January this year, we have had approximately 1,800 development applications, representing close to 150,000 lots or premises. On the latest projections we have, we plan to pass approximately 65,000 lots and connect approximately 40,000 premises during the coming fiscal year in Greenfields."[12]

Confidentiality and Accountability

From the outset, the NBN Co has claimed a broad right to confidentiality, despite the fact that it is entirely financed with taxpayers' funds and has effectively been granted a statutory monopoly over fixed line local access networks by the Government.

NBN Co CEO Mike Quigley has asserted that the Joint Committee has limited rights to scrutinise commercial deals signed by the NBN Co because they involved external counterparties. In evidence to the Committee Mr Quigley's description of some of these deals provided only the most cursory rationale for this secrecy:[13]

11 NBN Co, (2010), Corporate Plan, p.46.

12 Mr Mike Quigley, NBN Co CEO, Transcript of Evidence, Canberra, 5 July 2011, p.3.

13 Mr Mike Quigley, NBN Co CEO, Transcript of Evidence, Canberra, 5 July 2011, p.16.

> **Mr Quigley:** I can tell you now. For example, one is a migration. The other is a de-commission. One is for two types of technology. The other is for one type of technology. There is a whole bunch of commercial commissions, some of which I am not prepared to reveal because they are commercial deals with two external companies. But I can assure the committee that the company took a great deal of time and care in making sure that we protected taxpayers' funds in these deals.
>
> **Mr FLETCHER:** And that assurance would carry a great deal more weight if you would give us the specific figures and the rationale for any difference in the figures.
>
> **Mr Quigley:** I cannot give you the specific figures, because they are confidential. But what I can assure you is that there have been independent reviews—as you probably know—of the deals commissioned by the government.
>
> **CHAIR:** Will they remain confidential?
>
> **Mr Quigley:** In that case, I think yes. Some specific figures will probably remain confidential.

While appreciating that some matters are genuinely commercially sensitive, the Coalition members of the Committee do not see why a commercial contract should receive automatic and blanket protection from Parliamentary scrutiny simply because it involves a private sector counterparty.

The NBN Co has also claimed broad immunity from Government procurement standards. Mr Quigley told the committee:[14]

> **Mr Quigley:** First of all, if I could clarify the premise of your question. As a government business enterprise we are not subject to those Commonwealth procurement requirements.

The Coalition members are concerned over NBN Co's disregard of Commonwealth procurement requirements, particularly in regard to the April 2011 suspension of the tender process for construction contracts and subsequent decision to enter exclusive negotiations with a single party.

In this light it is notable that the NBN Co's own corporate plan states:[15]

> "NBN Co's procurement strategy was approved by the Board in December 2009 and is anchored on proven principles. These principles serve two purposes. Firstly, to guide the detailed activities of NBN Co and focus on the correct outcomes. Secondly,

14 *Ibid*

15 NBN Co,(2010), Corporate Plan, p.57

> to demonstrate alignment to the essential probity, transparency and value requirements articulated by the Department of Finance and the Australian National Audit Office (ANAO)."

NBN's Divergence from Government's Statement of Expectations

Given that the NBN Co is operating at arm's length from the Government – a point Senator Conroy has been repeatedly willing to emphasise - it is of particular concern that the NBN has failed to comply with the Government's Statement of Expectations in several important areas.

In a press release dated 17 December 2010, the Government's Shareholder Ministers stated: "That NBN Co will be the wholesale provider of last resort for fibre connections in new developments."[16] But subsequent changes to Government policy and the NBN's business model have meant that NBN Co itself will cover most of the upfront cost of rolling out fibre in most Greenfields sites - meaning the NBN Co will be the fibre provider of first resort, the exact reverse of the Government's original expectations.

The head of the Greenfields Operators of Australia, Mr Michael Sparksman, described this situation in evidence to the Committee:[17]

> **Mr TURNBULL:** At the moment, a developer has the option of either waiting for the NBN to install fibre at no cost to the developer other than providing the infrastructure—the passive pipes, pits and so forth—or paying one of your members to do it. Correct?
>
> **Mr Sparksman:** That is correct.
>
> **Mr TURNBULL:** So that basically puts your members in quite an uncompetitive position, doesn't it?
>
> **Mr Sparksman:** It does.
>
> **Mr TURNBULL:** Does it put you out of business?
>
> **Mr Sparksman:** It does, yes.
>
> **Mr TURNBULL:** So it is not a fine issue of competitive neutrality. It seems you are just run out of town, basically, by the government dollar, aren't you?

16 DBCDE, (2010)

17 Mr Michael Sparksman, Chairman, Greenfield Operators of Australia, transcript of evidence, 16 May 2011.

Mr Sparksman: That is correct.

The Statement of Expectations also stated that keeping the cost of services down should be a key policy objective of the NBN: "The Government's objectives include delivering significant broadband improvements to all Australians and affordable access to these services is essential."[18]

However, the Committee notes that in NBN Co's discussion paper of July2011 on its Special Access Undertaking expected to be submitted to the ACCC by the end of 2011, the NBN Co has proposed that only one of its services be subject to below-inflation price controls during the first 15-20 years of the NBN's operation. The organization indicated it will seek the ACCC's permission to be able to raise the prices of the remainder of its services – including any consumer service offering higher-speed downloads than are feasible with today's peak ADSL speeds, any services designed for business customers, and any services related to multicasting or video streaming – by significantly more than the inflation rate between now and 2041:[19]

> "All NBN Co products (i.e. both price controlled and non-price controlled products) would be individually subject to a price shock mechanism that restricts annual price changes of any individual product to no greater than CPI+5%. Prices would, in addition, be subject to any validity periods specified in the WBA."

As noted earlier, the NBN Co's attempt to lock in up to thirty years of real price rises for the communications and entertainment services to be carried over its networks is a remarkable turnaround from the large real price falls for most such services in Australia and other OECD countries which embraced increased competition and deregulation of the communications sector over the past two decades. Between 1997-98 and 2008-09 inflation-adjusted prices fell 34 per cent for fixed-line telephone services and 49 per cent for mobile services, according to the ACCC.

In fact the trend towards lower real prices goes back even further, to well before market liberalization: Between 1980 and 2011, the ABS index of telecommunications services fell by approximately 55 per cent in real terms.[20]

18 DBCDE, (2010), "*Statement of Expectations*".

19 NBN Co, (2011), "*Introducing NBN's Special Access Undertaking*", p.23.

20 ACCC (2010) "Changes in the prices paid for telecommunications services in Australia 2008-2009," p.101 Canberra 2010.

NBN Co Commercial Arrangements with Telstra and Optus

From the outset, one obvious danger in creating a large and vastly over-capitalised taxpayer-funded local access carrier was that its need to seek a return on capital would lead to it (and its owner, the Commonwealth) artificially stifling competition from existing or prospective rival networks or technologies. This is precisely what has come to pass, much more quickly than anyone anticipated and in direct conflict with the Government's claims in April 2009 (when it was at least contemplated that existing infrastructure capable of delivering super-fast broadband would remain as a competitive check on NBN Co and not be wastefully decommissioned).

The Coalition members of the Committee point out that NBN Co's agreements with both Telstra and Optus to legislatively and contractually prohibit the provision of broadband services over their respective Hybrid Fibre Coaxial (HFC) pay TV networks was neither recommended nor foreshadowed either in the NBN Implementation Study (April 2010) or the NBN Corporate Plan (December 2010).

The McKinsey/KPMG Implementation Study made the following statements about the HFC networks:

> "NBN Co, as a monopoly after completion of the roll-out and if the copper and HFC network are deactivated will lack the competitive pressure to optimise its operations. This could lead to several adverse outcomes for the industry including:
>
> ⇒ Higher prices charged to operators …
>
> ⇒ Poor quality of services …"[21]

The NBN Co 2011-2013 Corporate Plan makes no mention of a competition-stifling agreement deal with Optus, although such an arrangement was already presumably under negotiation at the time it was published. In regard to NBN Co's commercial arrangement with Telstra, the Plan states:

> "In a fully competitive scenario (i.e. assuming no deal with Telstra, see Sub-Section 3.1.1, *Telstra Definitive Agreements*) it is likely that one of the existing HFC networks will be upgraded at least to encompass node splitting, thus being able to offer speeds of over 200Mbps to over 2 million premises but with substantially lower performance than GPON (lower upstream speeds and higher contention ratios)."[22]

21 McKinsey (2010), "*Implementation study*", p.444.

22 NBN Co, (2010), Corporate Plan, p.43.

NBN Co has maintained it required broad legal and political protection from any independent scrutiny of the agreements it has entered into. For instance, asked for a breakdown of the per user cost of the respective Optus and Telstra contracts, NBN Co CEO Mike Quigley stated:

> "I am not at liberty to divulge that information. It is commercially sensitive information from either Telstra or Optus."[23]

It is clear the main purpose of the deals is to prevent facilities-based competition and protect the economics of the NBN project. In a letter to the ACCC dated 22 August 2011, NBN Co CEO Mike Quigley and DBCDE Secretary Peter Harris stated:

> "The HFC network clearly offers the ability to 'cherry pick' high value customers thereby potentially inhibiting NBN Co's ability to cross subsidise to deliver national wholesale pricing. The Parliament has recently authorised NBN Co to engage in conduct that is reasonably necessary to achieve uniform national wholesale pricing. Decommissioning of the HFC network would further support the achievement of this objective."[24]

In regard to the deal with Optus, Treasurer Wayne Swan and Communications Minister Conroy have explicitly conceded that it was designed to boost NBN Co's revenue and take up:

> "The Optus agreement to migrate its HFC customers to the NBN and to decommission its HFC network will provide greater certainty about NBN Co's revenue, and will further increase the take-up of NBN services."[25]

NBN Prices

It is of the deepest concern to Coalition members of the Committee that neither the Government nor NBN Co have shown the slightest interest in the affordability (and hence uptake) of broadband services being a key performance indicators and policy objective as a key policy goal of the project.

On the contrary, given the contradiction between the Government's determination to choose the most expensive possible upgrade path for Australian fixed line communications, and the Government's insistence that the project will earn a (barely) commercial return (as opposed to being a heavily subsidised Government

23 Mr Mike Quigley, NBN Co CEO, Transcript of Evidence, Canberra, 5 July 2011, p.15.

24 DBCDE, (2011), "*Cover Letter to the ACCC*".

25 Stephen Conroy and Wayne Swan, (2011), "NBN Rollout to Benefit from Deal with Optus", 23 June 2011.

service like education or health), the only possible outcome is higher prices and the necessary elimination of all fixed line competition to enable them.

In publishing the NBN Co Corporate Plan, the NBN Co set itself a number of ambitious goals which will be detrimental to consumers. RBS investment analyst Mr Ian Martin notes:

> "Wholesale revenue forecasts in NBN Co's Corporate Plan 2011 – 2013 are based on two options, Option A (1) and Option A (2), respectively forming upper and lower boundaries of the corporate plan's scenario range. The two revenue scenario options are not greatly different over the three year corporate planning period, with the first option modelling a blended average revenue per activated line (ARPU) of $34 per month by the end of the three year corporate plan (FY2013) and the lower bound ARPU of $33 per month. These would help generate revenue of $154m to $160m from 566,000 connections in FY13 (or $224-231m annualised). These 'prices' are more than three times higher than the current blended price paid by broadband access seekers for access to copper. Although there are some important differences in the access product offered on copper compared with the proposed fibre access product of NBN Co it highlights the question of ability to pay."[26]

The pricing regime of the NBN Co also contrasts with the experience of carriers elsewhere in the world. For instance there has been a decline in the number of Korea Telecom's subscribers to 100 megabits per second broadband in Korea, where there is a price premium of only 3,000 Won ($A2.62) to move from the 10mbps plans.[27]

Early NBN prices published by Retail Service Providers (RSPs) indicate that while prices for basic ADSL2 equivalent packages are roughly in line (or slightly above) plans currently available, the RSPs have factored in significant price premiums to upgrade to faster speeds. For instance, Internode are charging a $40 premium to move from a 12/1mgbps package to a 100/40mbps contract with the same bitcap.[28]

The Coalition also views with considerable alarm the NBN's special access undertaking lodged with the ACCC, which proposes yearly price rises of up to

26 Martin, I, (2011), "A Significant Gap in the NBN Corporate Plan," in the *Telecommunications Journal of Australia*, Vol 61 No 3, p51.3.

27 For more information see Turnbull, M., (2011), "*Korea Broadband: An Overview and Implications for Australia*".

28 Internode, (2011), "*NBN Fibre to the Home*".

CPI+5% on all products except basic ADSL2-equivalent packages for a period of thirty years.[29]

Although it is hard to find an apples-to-apples comparison, it is worth noting that OECD figures show ADSL retail prices in Australia fell by 69 per cent between 2005-2010.[30]

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on the National Broadband Network

29 NBN Co, (2011), "Introducing NBN's Special Access Undertaking", p.23, available online here.

30 OECD, (2011), *Communications Outlook*, p.293.