

NBN - what went wrong and how it can be fixed
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Both the Government and Telstra need a successful outcome from negotiations over compensation for the use of Telstra's assets and the migration of its customers to the National Broadband Network (NBN). The risk of failure is high because the Government is making policy on the run and compensation issues appear to be intractable. But the project can still be rescued with common sense.

A core 2007 election promise was to build a national broadband network (NBN). It seemed obvious that Telstra was best-placed to build a fibre-to-the-node (FTTN) network. The beauty of FTTN was (a) it is cheaper than the fibre-to-the-premise (FTTP) network now promised but delivers most of the same benefits, (b) all existing wholesale access revenues automatically vest with the access network operator making wholesale-only operation more viable and (c) there is a natural customer migration as the current copper network morphs into the FTTN.

But Telstra failed to lodge a complying bid and the Government belatedly realised that nobody else could build an FTTN and pay Telstra around \$20bn for access to the last few metres of copper from the node to the premise.

Nobody dreamt that the Government would try and finesse the \$20bn compensation issue with an all-fibre network (FTTP) that would by-pass Telstra's copper. This "courageous" ministerial decision, which earned plaudits from the industry last April, is fraught with danger. It tasks a multi-billion dollar project of unusual complexity to an un-tested start-up company (NBN Co). It will cost about three times more than an FTTN network. And, there is still a compensation issue because NBN Co. needs Telstra as an anchor tenant and access to Telstra's assets to reduce costs.

This nation-building project needs Telstra's willing cooperation; the "win-win" promised to Telstra shareholders. The Government needs both sticks and carrots to enlist Telstra. So far, all we have seen publicly are the big sticks. The most recent draft legislation which may allow NBN Co. to offer some retail services contradicts the policy of separating wholesale and retail business and has alarmed many industry players; not just Telstra.

Three possible outcomes of the current impasse appear to be:

Scenario A – the Government has already aborted one NBN process and laid the blame on Telstra. It might do so again (after the election). Its consultants may be telling it that it has a lemon because wholesale-only is not a viable business model (don't believe all you read) or because NBN Co. cannot compete with alternative broadband networks; including mobiles. Life for Telstra could be made very difficult so we would have a lose-lose outcome.

Scenario B – head-to-head competition between NBN Co. and Telstra. Again, life would be made unpleasant for Telstra. But NBN Co. would not achieve the economies of scale it needs. It is not just Telstra that would refuse to migrate its customers to NBN Co. Telstra's competitors will not move unless wholesale prices on the brand new NBN are at least as cheap as they enjoy now. The fact is that any NBN will involve a shake-up of the industry which can be avoided while an alternative (Telstra's

network) exists. The costs of the last public telecoms venture, AUSSAT, were buried in the sale of the second fixed licence to Optus. It is not clear what kind of fire-sale of NBN Co. assets might be the end-game under this scenario but it is easy to envisage the government making no direct return on investment.

Scenario C – while Telstra’s previous management rejected any notion of a joint-venture, this might provide a way forward now. Migration of customers to the NBN and the closure of its copper-based network achieves a separation acceptable to Telstra while helping to assure the future of the NBN; a win-win outcome. The issues are (a) that the Government will not accept an ownership stake by Telstra in NBN Co. commensurate with its in-kind contributions and (b) Telstra shareholders will not accept shares in NBN Co. unless it is a commercial venture. Maybe Telstra would accept Aussie infrastructure bonds in exchange for its cooperation? Maybe there would be an option to swap these into equity later? These financial issues are surely soluble? If so, we shall get the win-win outcome we all want.

Correction – do not assume we all want the NBN. Many ISPs are more than happy with the status-quo. If they have to pay more for access, their future is grim. Note the shock-horror reaction of ISPs to the ACCC’s draft pricing decision in August 2009 to set ULLS prices on a “glide path” towards NBN compatible pricing to reduce the price shock of moving to the NBN while also moving towards averaged wholesale access prices. The ACCC backed-off and left current prices on hold. The Government will need stronger nerves if it is to realise its broadband goals.

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