

Time to take the gloves off

Wholesale pricing should be simple. NBN pricing is not, and it is getting more complex. But the reforms proposed below will get things back on track and reset the sector for success - measured by broadband being fast and affordable for consumers, at least slightly profitable for retailers and losing as little as possible for the NBN.

Some history

In early 2018, the NBN started bundling speed (AVC) and capacity (CVC) charges. As expected, this is leading to strident calls from the industry to abolish CVC charges because they are driving up the average revenue per line (ARPU; currently \$45 wholesale per month for residential users).

The NBN was initially priced to match Telstra's depreciated copper access network despite the enormous cost. The resulting prices are much lower than would be allowed by regulation given the cost. In FY20, the difference between actual and allowable revenue (derived from the regulated asset base) was over \$5 billion in unrecovered costs (equal to an extra \$50 per month for 8m households). The annual deficits are stashed in the initial cost recovery account (ICRA) which grows with interest.

There is no constraint on prices because the ACCC allows the NBN to draw down the ICRA which now stands at \$32 billion. But competition from mobile broadband will prevent the NBN making much use of the ICRA. Currently, Telstra and Optus are getting \$2 billion a year for migrating their customers to the NBN. When this compensation dries up in FY22 (NBN 2020 Annual Report, 56), the gloves will come off and mobile broadband competition will increase.

Speed (the AVC)

Higher speeds can be obtained on a mobile device than on an affordable NBN line for many users. Carriers are providing NBN modems that have 4G backup limited to 25Mbps for an NBN outage. That will change as the obvious source of earnings growth will shift from putting consumers on the NBN to moving them off it.

The NBN wants us to believe its ARPU can keep increasing. This is a fantasy to avoid facing the inevitable asset write down that is needed to allow the NBN to compete with mobile broadband. To do that, it will also need to remove the speed constraints (AVCs) on NBN fixed lines. This would also help improve Australia's respectable global ranking – this month Australia is 7th for mobile broadband at 110Mbps and 57th with 71Mbps in fixed (speedtest.net). If the network supports it, it costs no more to provision 100Mbps than 25Mbps so, like mobile speed, fixed speed should not be rationed. Removing the AVC constraint on speed isn't a missed revenue opportunity because higher speed leads to greater usage.

The NBN's 2014 industry consultation paper looked at five pricing options including getting rid of either AVCs or CVCs. These were critiqued in "[Hobson's choice](#)" (August 2014) which estimated that abolishing the CVC without a write-down and planning for flat ARPUs consistent with global trends would need a wholesale ARPU of around \$75. This isn't realistic.

Usage and CVCs

Apart from making AVCs less affordable, removing usage fees would make the transfer of value to Google, Facebook and others more certain. The NBN may have dumb pipes but it is not stupid. It needs a usage fee to extract some value from increasing video and other traffic to keep investing in its network.

Telstra's submission to the current NBN consultation is reported as proposing that NBN charge for actual usage. An excellent idea. Telstra wants to abolish the overage charge for exceeding purchased capacity, order more capacity than it needs and be charged only for the capacity it uses (95th percentile).

We agree that all service providers should be provisioned with more capacity than they can use. But a simpler approach to maintaining growth potential, is to replace capacity (CVC) pricing with traffic pricing (cents/GB). If NBN is to gain from increased usage, the obvious metric is usage itself – just as mobile networks charge for gigabytes consumed. Can you imagine a water company, gas company or electricity supplier charging by the size of the pipe and artificially constricting the flow? It would be crazy. The obvious answer is charge for what flows through the pipe – gigabytes in the case of broadband.

A usage charge doesn't make it impossible to offer unlimited plans – though it would make usage-based plans more attractive for the 85% or so of households below the mean usage.

Affordability

Adopting these reforms, the NBN could also create an entry broadband offer with a low fixed fee with speed capped at, say 100Mbps combined with a high traffic fee. Such an entry level plan does not need much administration. As usage grows, the service provider reduces costs by migrating the end user to the standard wholesale price with a higher fixed fee and lower traffic charge.

A two-part tariff, fixed fee plus traffic fee, is an efficient way of recovering fixed costs. It is simpler than what we have now and also allows the creation of an entry level broadband offer. Done right, NBN will get as much ARPU growth as the market will bear before consumers (or at least those in the top 10%) limit their usage, retailers will more readily get a modest profit and Australia will rank as high in the world as the NBN technology allows rather than being hobbled by the pricing. If NBN doesn't choose such a model soon, just wait until the gloves come off.

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