Vocus’ submission in response to ACCC consultation paper -

Proposed NBN Special Access Undertaking variation

July 2022

Response to proposed NBN SAU variation 2022

Vocus welcomes the opportunity to provide feedback to the Australian Competition and Consumer Commission (ACCC) on NBN's proposed variation to its Special Access Undertaking (SAU).

The SAU is a critical part of the regulatory framework that governs the terms on which NBN supplies services to retail service providers (RSPs).

Vocus' response focuses on NBN's proposals concerning pricing. Vocus serves residential consumers and small businesses through its retail brands, Dodo, iPrimus and Commander (Vocus Retail). Vocus also provides wholesale NBN services to RSPs.

Telecommunications services are more fundamental now than ever to the lives of Australians. However, should NBN's proposed changes be accepted NBN's wholesale prices will rise and increase every year, compounding current cost of living pressures.

Vocus understands the market segment looking for value and affordable broadband, with nearly 90% of our retail residential customers on speed tiers at 50 Mbps or below.

Our key concerns are that NBN's proposed approach to pricing includes:

- retention of CVC usage charges for speed tiers below 100Mbps
- high wholesale price levels
- increasing wholesale prices on a yearly basis at CPI or CPI+

NBN has missed a critical opportunity to provide an approach that enables affordable and reliable connectivity and supports a sustainable and competitive market for RSPs. NBN's proposals do not resolve the significant challenges RSPs and consumers are facing. Industry returns have been severely impacted over the past 5 years. While some RSPs could wear lower margins as they competed for market share during the rollout period, NBN retail prices will now inevitably further increase for all players if NBN's proposed pricing measures come into effect.

Vocus has called for NBN's wholesale pricing to be affordable, predictable and simple. NBN has not delivered.

The ACCC should reject NBN's proposed variation to the SAU as it is not in the long-term interests of end-users. NBN's proposals do not promote competition or encourage efficient use of NBN's infrastructure. NBN's approach to pricing will lead to immediate and ongoing increases in costs, continuing complexity and uncertainty for RSPs. NBN's wholesale prices will continue to be focused on maximising NBN's financial returns, rather than addressing customer needs and the market reality of household spending levels. Affordable NBN services will be out of reach for many Australians.

The overall impact of NBN's pricing proposals is worse than the status quo for customers seeking standard affordable broadband. We request that the ACCC move to develop an Access Determination that will facilitate an approach to pricing that promotes the long-term interests of end-users. If an Access Determination cannot be finalised by 30 November 2022, then we request the ACCC consider issuing an Interim Access Determination to ensure that ultimately consumers do not suffer from the consequences of NBN's proposal to significantly increase wholesale prices.

Affordability

Vocus is very concerned about the impact of NBN's pricing proposals on affordability. In the latest Australian Digital Inclusion Index, it is highlighted that in 2021 26% of Australians in the lowest income quintile, and 18% of those in the second lowest, are extremely concerned about the cost of internet access[1]

We understand the price-sensitive market segment well, with nearly 90% of our retail residential customers on speed tiers at 50 Mbps or below. Our Dodo customers are traditionally those who require significant data (and therefore consume significant bandwidth) but seek to do so at the lowest available cost. The primary reason behind their choice of product is the retail price. Many of our Dodo customers are not willing to pay more for their NBN service. In 2021, following a $5 increase on our NBN50 plan, we had an increase in our churn rate of 30% compared to the previous 6 months.

Vocus highlights that NBN's touted "reduction in price" for the 25/5 Mbps service does not deliver increased affordability or efficient use of the NBN network. Rather than a price reduction, the construct will operate in practice as a price increase for a speed tier that represents 13% of all services in operation. While NBN has proposed a lower monthly charge of $26, the offer only includes 0.1 Mbps of CVC capacity. This is an approximately 93% decrease on the current CVC inclusion. If the bundled CVC allowances are exceeded in aggregate, a CVC overage charge of $8Mbps/month applies. The outcome of this "give and take" approach, is that to provide the same experience to our customers as we do today, we will need to spend $1 more than the current monthly bundled charge of $37 even before adding any variable overage charges. As data consumption continues to grow, these costs will only escalate, with a high likelihood that cost increases will ultimately need to be passed on to end consumers.

NBN's proposal to only include 0.1 Mbps of included CVC capacity in its 25 Mbps offer may be designed to encourage RSPs to offer a product with data usage caps, which is something that the industry has moved away from over the past several years. However, this does not meaningfully address affordability concerns. Customers seeking affordable broadband are not necessarily low-usage customers. Vocus wants to sell products that meet our customers' needs to enable them to access the internet, video and streaming services in an unconstrained way. If Vocus was effectively forced to reintroduce data-capped products, then this would be counterproductive from the perspective of what we are offering our customers today. As consumers connect more devices and use data for more and more daily activities, the reintroduction of data consumption constraints forced by NBN wholesale pricing would be out of step in a market now based on unlimited data download plans.

Should NBN's pricing changes be accepted, this will cause harm to consumers. Some consumers will not be able to absorb retail price increases. They will be priced out of the market and miss out on the social and economic benefits of NBN connectivity. There are already more than 1 million inactive premises where consumers have connected, disconnected, and not reconnected to an NBN service. More consumers abandoning the NBN will lead to further under-utilisation of NBN's infrastructure,

[1] Australian Digital Inclusion Index, Affordability dashboard: https://www.digitalinclusionindex.org.au/dashboard/Affordability.aspx

and this will reduce NBN's ability to further invest in the network and impact efficient use of the investment already made.

To promote efficient use of and investment its network, NBN's pricing needs to stimulate both take-up and retention of its services. Vocus' view is that there should be segmented pricing, where the prices of lower-end speed tiers are reduced proportionately compared to the prices of higher speed tiers. The higher speed tiers (250/25 and upwards) should then have comparatively higher prices and premium service levels. For example, a more reasonable entry level NBN25 product would have a flat fee around $30 and a product that is 10x quicker (e.g. NBN250) might be priced 5x more while a product that is 40x quicker (e.g. NBN1000) might be priced 15x more.

NBN prices will continue to increase, impacting RSP sustainability and affordability

NBN's proposal for prices to increase every year at a rate higher than inflation does not promote a sustainable market for RSPs or affordable prices for consumers.

To promote competition, NBN's pricing must allow enough retail margin for RSPs to recover their efficient retail costs of supply. Retail returns have been severely impacted during the transition to NBN. Over the last 5 years, our experience in the Vocus Retail business has seen NBN increasing its wholesale costs at double the rate of what we have been able to recover from price increases and product mix changes in our target segments. Put simply, Vocus cannot increase prices at the rates our wholesale costs are increasing and meet the needs of our price-sensitive customers on a sustainable basis.

If NBN's proposals are accepted, NBN will be even less profitable to sell, in a market that already has compressed margins. It is consumers who will ultimately wear the costs of ongoing price increases but only to the extent consumers can afford increases as other living costs rise. NBN's CPI +3% price cap formula could lead to annual price increases of 8 or even 10% at the Retail level.

Furthermore, RSPs will not be able to deliver price stability given NBN's permissible price increases. Our customers expect steady, or even falling, prices for the same service. In the ADSL broadband market, retail prices consistently trended down and our experience is that consumers expect to be getting greater value for their money over time.

Vocus does not agree with NBN's proposition that there will be an increase in the willingness to pay more due to ongoing increases in network traffic and the emergence of new applications and uses for the network. For many customers that we serve, price will continue to be the major guiding factor. For example, the NBN50 plan continues to be the predominant product our customers are choosing today in a price, speed, value triangle, despite changes in consumer behaviour such as greater working from home and the growth in video streaming services.

Vocus submits that over time, consumers should not pay more for their internet access than what they did in any preceding year, aside from the choice to pay more for a different experience. NBN's proposal to continue to increase wholesale prices at CPI+ is not linked to its efficient costs and ignores market reality on technical efficiency (and Moore's law). In fact, it is not clear to Vocus why NBN's wholesale prices continue to trend upwards. In other telecommunications markets such as backhaul and IP transit, for example, we have seen prices come down while capacity has gone up.

Under NBN's proposed model, RSPs will face immediate and ongoing cost increases in supplying NBN 25 and 50 Mbps services. For the critical NBN50 speed tier, NBN has proposed a substantial immediate increase in costs, with NBN proposing a fixed monthly charge of $50 with only 2.45 Mbps of included CVC. This is an immediate price increase on two fronts: an increased monthly charge of $5, plus a further cost increase as a result of the 7.5% reduction in the CVC inclusion. This represents an approximately 14% increase in RSPs input costs.

Importantly Vocus will also lose the benefit of economies of scale as the current more generous CVC inclusions on high-speed tiers will no longer be available to be shared/pooled across all AVCs as happens today.

High and increasing wholesale prices will also challenge the sustainability of smaller retailers who purchase NBN services from wholesale providers such as Vocus. This is not in the long-term interests of consumers given the role these retailers play in driving competition.

Implications for the market

To promote competition in the retail market, NBN's wholesale prices need to be sufficiently certain, sustainable and stable. However, NBN has proposed retaining CVC charges for speed tiers below 100 Mbps. Consequently, RSPs will continue to bear considerable financial risk to manage their customers' expectations. Over time, CVC costs will escalate at an uncertain rate as customer usage continues to increase. Ultimately this exposes end-users on these tiers to price increases and/or reduced quality of service or forces them to higher tiers that they may not require to meet their needs.

NBN's proposed pricing appears to be an escalation of its existing pricing practices, which have focused on maximising NBN's returns. This approach including short term discounts has artificially forced consumers up speed tiers as NBN seeks to increase its average revenue per user. This trend will be exacerbated should NBN's proposed pricing measures come into effect. The costs to RSPs for the 50 Mbps product will likely equal those of the 100 Mbps product within only a few years. Vocus is very concerned that this converging of pricing will not enable it to meet the needs of different consumer segments. Overall, NBN's approach to pricing will likely stifle RSP innovation and lead to more homogenous products.

NBN proposes a flat monthly charge construct for residential grade 100 Mbps and higher offers. It has submitted that as a result of reduced exposure to overage-related cost variability, RSPs "may be able to develop cheaper retail pricing on higher speed tiers." However, NBN has proposed an immediate price increase for the 100 Mbps product. Consequently, it is highly unlikely that RSPs will deliver cheaper pricing on this product given this price increase and the existing level of more generous CVC inclusions at this speed tier.

NBN's hybrid approach to pricing will also impair competition. The impact of NBN's proposal to retain CVC charges for speed tiers below 100 Mbps and offer flat monthly charges for 100 Mbps and higher offers will not be equally shared across RSPs. RSPs that over-index in the price-sensitive market will continue to wrestle with higher risk and complex variable usage charges. These pricing pressures will constrain their ability to compete and may push some RSPs out of the market. In contrast, NBN's proposals will deliver more price certainty for those RSPs that target high usage high speed customers or customers with a greater ability to pay.

Several RSPs already offer products that provide viable alternatives to the NBN. The incentive to offer and strongly promote such alternatives will only heighten if NBN's proposals are accepted, leading to further under-utilisation of the NBN network. RSPs will seek better margins and price certainty than those available in reselling NBN. Mobile network operators will also be seeking to recoup significant investments made in 5G networks. NBN's high and increasing prices will continue to act as a deterrent to efficient use of NBN's network. Consumers will be attracted to options that offer more affordable connectivity and value for money.

Misalignment between wholesale and retail models

NBN's retention of CVC usage charges does not support the way that RSPs sell NBN products, resulting in a commercial disconnect between the receipt of wholesale services and the products and services supplied to customers. That is, the consumption-based charge provided by the NBN at a wholesale level is entirely disconnected from the fixed charge provided by RSPs at a retail level. This disconnect needs to be urgently addressed. Vocus has suggested over a number of years that the NBN should implement an AVC only model. The NBN is only part of an internet service to an end user. Most variable costs are managed directly by RSPs, such as IP transit and capacity to NBN POIs, and create strong incentives for RSPs to encourage efficient use of NBN's infrastructure.

NBN needs to simplify its product construct by removing CVC charges. CVC charges are not a reasonable way to address affordability issues. In the price-sensitive segment of the market, the inadequate CVC inclusions for the 25 and 50 Mbps offers will continue to cause unpredictable overage costs. Our price-sensitive 25 and 50 Mbps customers are already using or exceeding CVC inclusions. Any benefit that retention of CVC charges may provide for low-income customers on data-capped plans with low usage needs, is outweighed by the high transaction costs and uncertainty the charges present for RSPs.

NBN asserts that its approach to the 50 Mbps speed tier significantly minimises the likelihood that these services will incur substantial overage charges. Vocus does not agree. The CVC inclusion for this key offer is insufficient to meet our customer demands today. This pricing pressure will be further exacerbated as the CVC inclusions will not grow as fast or at the same level as peak data demand. NBN has proposed to adjust bundled CVC inclusions by only 50% of the change in average aggregate peak CVC utilisation for a preceding 6-month period compared to the same period in the year prior, divided by two (to reflect the adjustment is applied for a 6-month period). Any CVC inclusion must be increased in line with end user demand.

If the bundled CVC allowances are exceeded in aggregate, a CVC charge of $8 Mbps/month applies to the CVC overage. This level of CVC charge bears no relationship to NBN's costs. There is no justification provided for it being set at $8 and for the charge not decreasing over time. This level of charge is irrational given that the higher intensity plans in terms of bandwidth do not have a usage charge but consume more of NBN's costs. This high level of CVC charge contributes to the commercial risk and uncertainty RSPs will face from CVC inclusions not being increased in line with end user demand.

Vocus submits that 50 Mbps and 25 Mbps should also have CVC charges removed. If they are retained in any form on entry level plans (e.g. NBN25), then the level of these charges must also be revisited and so that they decline over time.

NBN's proposal to charge for CVC usage based on peak utilisation is preferable to the current approach. However, Vocus does not agree with NBN's assertion that this new billing approach will remove the need for RSPs to actively forecast and manage CVC. Vocus does not expect any material cost savings from this move to utilisation billing from either an operational or a CVC usage perspective. Undue complexity will remain.

Vocus does not see how it could operate TC-4 Bundled Offers and TC4 AVC-only offers on the same CVC. A mechanism to control the amount of overage used on TC-4 bundled offers (in line with typical peak time speed claims), is not practical when traffic is blended between TC-4 bundled and AVC-only services. In the same CVC model, a RSP is subject to a variable charge from NBN each month based purely on usage in what is assumed to be the peak hour of the day. This usage may exceed the advertised typical peak time speed and therefore provides no certainty in controlling costs for the RSP. Consequently, NBN's proposed construct with a mix of TC-4 bundled offers and AVC-only flat rate offers will not provide the asserted simplicity in network operations or promote competition.

NBN's split pricing construct would also create a scale and transition challenge for RSPs, as TC-4 services reduce over time. RSPs must provision minimum bandwidths to the separated CVCs that support TC-4 bundle services to maintain advertised speeds in excess of the per SIO averages required with scale. At this point, there will be a cost decision to move the services to a higher speed tier on the NBN supply side and provide the end user with the speed of service acceptable to their needs being a lower tier. Managing CVC capacity will continue to create unnecessary complexity and inefficiencies for RSPs, adding to pricing pressures. From Vocus' perspective, CVCs will need to be split so we can control usage in line with advertised offers and reduce exposure to variable customer demand for TC-4 Bundled offers. Vocus will still need to invest in staff and systems to manage traffic given the retention of the CVC pricing construct. Vocus would prefer to be able to focus on innovation and delivering a good customer experience.

NBN's proposed discount threshold and "ratchet down" commitment does not protect consumers from price shocks, nor is it aligned with how RSPs sell products as they don't provide commercial certainty. Furthermore, the duration period of the discount is not fixed, nor is there any constraint on NBN withdrawing discounts. Accordingly, the withdrawal of short-term discounts directly impacts the prices that RSPs can offer their customers. To this end, the ACCC's wholesale market indicators reports have highlighted the impact when promotions such as Focus on Fast end, with the number of services over 100 Mbps falling by 40% in the March 2022 quarter.

NBN's discounting rules will require that, if the aggregate value of discounts to its residential grade charges exceed 5% of total residential grade revenues in a financial year, NBN must reduce maximum prices for residential grade products in the subsequent financial year. NBN will still be able to offer significant discounts, targeted to a particular product, for example, without exceeding this threshold. We question how effective this proposed threshold will be in seeing discounts offered by NBN result in decreased SAU prices.

Service quality

NBN has not made any commitment under the SAU variation to improve service quality.

RSPs bear considerable financial risk and responsibility to manage our customers' expectations and provide a good user experience. These costs place further pressure on an RSPs margins, with no certainty regarding the quality of service provided or a level of minimum expectations to be delivered by NBN. Given the considerable imbalance in bargaining power RSPs face in negotiating with NBN, the SAU should incorporate a baseline set of service standards, and to enable the ACCC to review these (and NBN's performance against them) to ensure they remain fit for purpose. The baseline should be at least those standards set out in the WBA4.

Utilisation management commitment

NBN's utilisation management commitment needs to be enhanced to provide sufficient certainty regarding service quality.

NBN has submitted it will take corrective measures where "utilisation of certain shared network resources in the transit backhaul network exceeds 95% for 15 minutes or more on three separate days in a 30-day period."

The utilisation commitment should apply beyond "certain shared network resources". NBN should report on and take corrective action on any aspect of their network where shared network resources could adversely affect end-user experience. To provide appropriate transparency, RSPs need to be provided with a full end-to-end picture for a specific service, not just an aggregated view.

The commitment to only report when the threshold is reached on "3 or more separate days" seems to be a method for NBN to iron out and not report on utilisation issues, such as gaming software upgrade nights that may impact service quality. In contrast, Vocus notes NBN currently informs RSPs if they breach 95% CVC utilisation rule, for a single hour in a single day. NBN should report to RSPs on any occasion where NBN's shared network resource utilisation exceeds the 95% threshold for 15 minutes or more.

Reporting

NBN proposes to incorporate reporting and transparency measures with respect to utilisation management, network performance and service levels. NBN Co proposes new reporting on network capability and some network availability metrics, such as outages and recurring faults. These reporting commitments may be useful to provide the ACCC with a high-level view of performance issues and to help RSPs to identify some systemic issues.

However, reporting of high-level aggregated metrics are not sufficient for RSPs to improve their operations. This type of reporting is not able to be used to affect an outcome for a particular customer. To address this NBN must provide accurate and timely information to RSPs about the performance of a service and issues that have a direct impact on customer experience. To better manage end-user experience, and respond to customer queries, RSPs need more reporting of matters such as congestion, intentional outages and performance at a per service level through tools like the service health card summary. Ultimately this will help NBN in their wholesale relationship with RSPs as well as aid RSPs in their retail relationship with end users.

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