

## **The Governance of NBN Co**

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I suppose some of you are here because I'm chairman of NBN Co. And I trust that some of you are here because you have a professional interest – even an intellectual interest – in corporate governance.

I personally have a keen interest in governance. I believe it is an under-examined aspect of corporate finance. I wrote a magazine article a dozen years ago predicting that economics was going to lose status and that governance was the coming thing. No one's written to me yet to tell me I was right. But there may not have been that many people who read the article. In any event, I'm pleased to be speaking to the Australian Institute of Company Directors, and I thank you for inviting me.

I'm also pleased – proud, actually – to be associated with the national broadband network and with the company that is building it.

The national broadband network is many things: a crucial piece of infrastructure that will benefit all Australians...a means of restructuring our telco industry so as to hasten the delivery of those benefits...and a godsend for copy-hungry journalists.

The NBN is important to Australia's future, so the scrutiny we get is entirely appropriate. The public is entitled to know how the company charged with building the network sets its course. So in the hope of pleasing everyone, I'm going to talk about how NBN Co is governed.

We are, as many of you will know, a Government Business Enterprise, or GBE. But before that, we are a corporation limited by shares, governed by the Corporations Act and the Commonwealth Authorities and Companies Act. Two Federal Ministers represent our shareholder, the Commonwealth. They are Senator the Honorable Stephen Conroy, Minister for Broadband,

Communications and the Digital Economy, and Senator the Honorable Penny Wong, Minister for Finance and Deregulation. However, as NBN Co is a Corporations Act company, the Board's foundation responsibilities are no different from those of any other company's board. Directors have a duty of care and diligence and a duty of loyalty. We must ensure we can meet our financial obligations. And we must act in the company's best interests.

What are those interests? What is our purpose? To answer those questions we must look to our shareholder, the Commonwealth. I emphasize the Commonwealth because we are apolitical and subject to the control and direction of the Government of the day.

So what has the Government told us it wants?

Our Constitution specifies – and I quote – that “the Company's objects are to roll out, operate and maintain a national wholesale broadband network while working closely with the Commonwealth during the implementation study in order to facilitate the implementation of Australian Government broadband policy and regulation.”

Those of you who follow the telco industry will remember the Implementation Study. The Government commissioned McKinsey & Company and KPMG to figure out what a national broadband network should look like and what it might cost. That work went on in parallel with the creation of NBN Co and the company's own planning. These two preparatory endeavors were expected to share insights – and did so.

By the time I joined the board, in March of 2010, the Implementation Study had been delivered. In my appointment letter, Minister Conroy articulated his expectation – and again I quote – “that NBN Co will...actively engage and consult with Government on broadband policy and support the Government's broadband policy initiatives....”

I go through all that language to demonstrate that, from the beginning, NBN Co has been designed as both an operating entity and a sort of think tank, which receives and tests and tries to carry into practical effect developing Government policy. Although the Department of Broadband,

Communications and the Digital Economy, representing our portfolio shareholder Minister, has primary responsibility for policy development, contributing a practitioner's perspective to that work stream is clearly part of our purpose.

For the benefit of those present who do not follow the industry, I should perhaps explain that, for at least 20 years, the Holy Grail of telco policy has been separating Telstra's wholesale and retail arms. To quote Graeme Samuel, Chairman of the ACCC – and it's always a good idea to listen to your regulator – he gave a speech in April of this year where he said, "...Telstra has become one of the most highly integrated telecommunications companies in the world, with vertical and horizontal interests. The ACCC has long said that competition in the industry has not developed to the extent initially envisaged when markets were first deregulated because of the highly integrated industry structure." Unquote.

Legislation recently passed attacks this issue head-on. Either Telstra structurally separates or it functionally separates. Functional separation means rejigging its organization and accounting systems, and setting up an independent Oversight and Equivalence Board for the wholesale business, to ensure that it treats its retail cousin and their independent competitors the same. That would be tiresome and expensive. Structural separation could mean spinning off the wholesale business as a separate company – which would also be a challenging task.

Fortunately for Telstra there is another path. They can structurally separate by decommissioning their copper network and migrating households to our fibre network as we roll it out. We like that approach because it accelerates the transition from copper to fibre. We also like it because, as part of the deal, we get to use existing Telstra infrastructure such as pits and ducts and exchanges. This saves us money, reduces our risk and disturbs neighborhoods less, all of which we are prepared to pay for. And as Chairman Samuel put it, "This provides the opportunity to remedy the errors of the past, reshape the industry and ensure that the underlying structural foundations encourage investment and competition...."

So you see, in finding a commercially attractive way of fulfilling our core purpose – rolling out a national broadband network – NBN Co will also be helping the Government attain the Holy Grail. The Board of NBN Co can't assign any financial benefit to the Holy Grail. But it is rather neat, the way it works out.

Structural separation of Telstra's wholesale and retail arms is by no means the only policy objective the Government is pursuing. The biggest benefits of broadbanding Australia will come in the delivery of health and education services...in the way rural and regional towns and households overcome remoteness... and through increased productivity in the small and medium-size business sector. It turns out – and I like this because it's high tech and low tech at the same time – it turns out you can use high-speed broadband, delivered via satellite, to move your cows from paddock to paddock without the expense of fences. These benefits are all part of our purpose, though they don't hit our financial statements.

Some of you were probably wondering when I'd get to financial outcomes. Let me be clear. This is a thirty- or forty-year project. Anyone who tells you he can see that far into the future is...um...speaking metaphorically. But we do have a detailed multi-decade financial model. It represents our best judgment and it allows us to compare alternative strategies.

Our current projection of financial outcomes is that the internal rate of return on this project is slightly better than 7% per annum. No private sector investors would undertake a project of this character for such a return...which is why the Government is doing it...just as governments build most of the world's infrastructure. But how can the Board of NBN Co approve the project?

The answer is that our Shareholder hasn't given us a return hurdle. They've given us a task and asked us to keep them posted.

To be accurate, they have given us a number of tasks and sub-tasks. (I'll talk about reporting and oversight in a bit.) Our responsibilities are laid out in a document called a "Statement of Expectations." It was sent to us by our Shareholder Ministers, Senator Conroy and Senator Wong. It was sent last December, and reflected the Departments' consideration of the

Implementation Study and input from NBN Co. It runs to 13 single-spaced pages. And we get further directives from time to time, sometimes in response to questions we ask the Government, sometimes as a result of its own policy development.

Responding to the Statement of Expectations requires us to make commercial judgments and commercial choices within a framework of communicated policy intentions. In this we are not totally different from normal listed companies, whose shareholders want both dividend income and growth, but expect the board to balance those sometimes conflicting objectives.

And like other boards, we have found that the best way to serve our Shareholder is to listen carefully, and then to put forward a business plan. The GBE Guidelines in fact require us to submit a new three-year Corporate Plan every year. We submitted one in December of last year, which the Government has endorsed. Because NBN Co's business is building and operating long-term infrastructure, we attached our multi-decade model to the Corporate Plan, and expect to do so each year.

One section of the Statement of Expectations reads, and I quote, "The Government's vision for NBN Co is that it operates as a commercial entity. NBN Co has been established as a wholly-owned Government Business Enterprise...with the intention that at an appropriate time, NBN Co will raise debt on its own behalf."

Those are entirely reasonable expectations for a big piece of operational infrastructure. But we are some years away from full operations. So when we submit a business plan that contemplates borrowing, we feel an obligation to remind our Shareholder Ministers – who know this perfectly well, by the way – that borrowing capacity depends on our financial performance and on market conditions. I think the technical term for reminding them of this is "CYA."

The Statement also calls for "uniform national wholesale pricing." We will charge retail service providers the same amount to provide voice and internet access to every premise in the country across our network. This means that we will subsidize hard-to-serve households by charging heavy

users in easy-to-serve neighborhoods more. For this to work, we have to be protected from niche wholesalers who might seek to undercut our prices in lucrative areas.

In this regard we are similar to Australia Post, which requires the same stamps on a standard envelope whether it is being sent around the corner or from Melbourne to Perth, and which is similarly protected against cherry-picking – another technical term – by having the exclusive right to deliver letters up to 250 grams anywhere in Australia.

The Statement of Expectations says that “The Government notes and agrees with the assumption inherent in the business plan that NBN is to be planned as a monopoly national fixed line network....” And there is language describing steps the Government is prepared to take to make this so, including the imposition of a levy on any wholesale operator seeking to serve Brighton and Toorak but not the bush. This issue is sufficiently important to our business model that we mention it whenever we can.

I said earlier that the Board of NBN Co makes commercial choices within a policy framework. We also try to keep visible the commercial constraints within which policy must operate. The capacity for doing that is one of the merits of the GBE format.

Before I end, I want to say a word about oversight, which is an important aspect of governance for any public entity. Very briefly...

- We are of course a regulated entity under several statutes, including the Telecommunications Act 1997, under which we are a licensed carrier, and our very own National Broadband Companies Act 2011, which contains provisions ensuring that NBN Co operates on a wholesale-only basis.
- We are audited by the Australian National Audit Office, which has contracted with Pricewaterhouse Coopers to do the work.
- We furnish ASIC with our annual report, and keep them up to date about things like equity injections and changes in the composition of the Board.
- We report progress to our Shareholder on a quarterly basis.

- Our executives appear before Senate Estimates, which normally take place 3 times a year.
- They also appear before the Federal Parliament's Joint Committee on the National Broadband Network, chaired by the independent Member for Lyne, Robert Oakshott, MP, which expects to convene every six months until the NBN is complete and operational.
- We are also subject to scrutiny at the House of Representatives Committee on Infrastructure and Communications.
- And just for good measure, there is the Regional Telecommunications Independent Review Committee, a non-Parliamentary body which provides advice to the Government on the adequacy of telecommunications services in the bush.
- We will shortly be subject to the Freedom of Information Act, which contains a sensible carve-out for commercially sensitive information. Without that carve-out, vendors could interrogate our files to discover our price expectations and negotiating strategies.
- We respond to written questions from members of Parliament. So far in 2011 we have received more than 210 such questions.
- Our management is in contact with our Shareholder Ministers and their departments on a daily basis.
- And we quite understandably get a fair amount of attention from the press, from industry and from interests groups and consumers.

Broadbanding Australia will transform the country. It will deliver benefits already available in other countries – and indeed services that don't even exist yet – and deliver them to every home and hamlet. Doing the job right calls for a blend of skepticism and vision. In cooperation with our Shareholder Ministers and their departments – and occasionally with prodding from well-intentioned critics – we believe we are supplying both.

But let me know if you disagree.

And thank you for your attention.