



NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology
2016-17: Final Determination

and

Price compliance reporting 2016-17

June 2018

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List of abbreviations and acronyms

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
CFO	Chief Financial Officer
CFRA	Carry Forward Revenue Adjustment
CPI	Consumer Price Index
EGM	Executive General Manager
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
NBN	National Broadband Network
NBN Co	NBN Co Limited
Optus	SingTel Optus Pty Ltd
RAB	Regulatory Asset Base
SAU	Special Access Undertaking
Telstra	Telstra Corporation Limited
WBA	Wholesale Broadband Agreement

Executive Summary

Under NBN Co's Special Access Undertaking (SAU), the Australian Competition and Consumer Commission (ACCC) must make a Long Term Revenue Constraint Methodology (LTRCM) determination each year until 2023. This report sets out the ACCC's final LTRCM determination and view on NBN Co's price compliance for the 2016-17 financial year.

The SAU contains the framework for regulating access to the National Broadband Network (NBN) until June 2040. Schedule 1E of the SAU establishes the LTRCM, which is a methodology for determining NBN Co's annual regulated revenue, regulated asset base and the account for accumulating initial unrecovered costs that NBN Co can recover later in the SAU period. The LTRCM is one of the various components of the SAU that combine to provide incentives to NBN Co to invest prudently and efficiently.

Under Schedule 1F of the SAU, NBN Co must submit certain regulatory information to the ACCC each year, including its proposed financial information and reports certifying its expenditure and procurement compliance. NBN Co is also required to certify that it has complied with the price controls in Schedule 1C of the SAU. NBN Co submitted its regulatory information for 2016-17 on 31 October 2017.

For the LTRCM determination, the ACCC must determine the values (and inputs to those values) for the:

- annual building block revenue requirement (ABBRR) – the amount of revenue NBN Co is allowed to earn in each financial year
- regulatory asset base (RAB) – the net value of NBN Co's regulated assets, and
- initial cost recovery account (ICRA) – an account for accumulating (and rolling forward) NBN Co's initial unrecovered costs.

On 3 November 2017, the ACCC published NBN Co's regulatory information, supporting submission and its actual and proposed financial information. On 27 April 2018, the ACCC published its draft LTRCM determination in which it proposed to accept NBN Co's proposed values (and inputs to the values) and was satisfied that NBN Co had complied with the price controls set out in the SAU.

In response to the draft determination, Telstra made a submission and NBN Co and Optus each made cross submissions. Telstra, supported by Optus, asked the ACCC to provide guidance on whether recent pricing initiatives announced by NBN Co by way of discounts under the SAU should be categorised as NBN offers, which would attract certain protections under the SAU. Telstra (also supported by Optus) also queried how expenditure undertaken by NBN Co for trials and for enterprise customers should be treated under the SAU. NBN Co has provided a submission in response to Telstra's submission setting out its view on both matters.

The submissions expressly note that the matters raised are not directed to the ACCC's acceptance of the proposed values for the LTRCM or NBN Co's compliance with the price controls. The ACCC also notes that the pricing initiatives announced by NBN Co, and in relation to which Telstra and Optus seek guidance, were implemented after the relevant period being considered as part of the 2016-17 LTRCM determination. The ACCC therefore proposes to maintain the position set out in its draft determination, and make its final LTRCM determination for 2016-17 to accept NBN Co's proposed values (and the inputs to those values) for the ABBRR, RAB, and ICRA without modification, in accordance with clause 1E.1.2 of the SAU. Regarding price compliance, the ACCC is satisfied that NBN Co's prices for 2016-17 did not exceed the applicable maximum regulated prices in accordance with Schedule 1C of the SAU.

However, the ACCC acknowledges that the introduction of bundled products by NBN Co as 'discounts' raise some questions that may be of broader concern. The ACCC therefore proposes to consider the submissions of Telstra and Optus, together with the submission in reply made by NBN Co and will provide guidance on the approach taken by NBN Co.

1. Introduction

1.1. Purpose

The Australian Competition and Consumer Commission (ACCC) accepted NBN Co's Special Access Undertaking (SAU) on 13 December 2013. The SAU establishes the framework for regulating access to the National Broadband Network (NBN) until June 2040. The SAU has a modular structure: Module 0 provides the overarching structure and applies for the full term of the SAU, Module 1 covers the initial regulatory period until 30 June 2023 and Module 2 covers the subsequent regulatory period from 1 July 2023 to 30 June 2040.

The SAU establishes the Long Term Revenue Constraint Methodology (LTRCM). The LTRCM is a methodology for determining NBN Co's annual regulated revenue, regulated asset base and the account for accumulating initial unrecovered costs that NBN Co can recover later in the SAU period. During Module 1, the LTRCM is one of the various components of the SAU that combine to provide NBN Co with incentives to incur only efficient expenditure and to price reasonably to promote the long-term interests of end users.¹ The LTRCM process gives NBN Co the opportunity to recover its prudent and efficient costs of supply, including an appropriate return on investment.

The SAU requires NBN Co to submit certain regulatory information to the ACCC each financial year as part of the LTRCM process. NBN Co's submission must include the financial information necessary to determine its allowed revenue.² NBN Co must also certify that its prices have not exceeded the maximum regulated prices set in the SAU during the relevant financial year.³ Following NBN Co's submission, the ACCC must make an LTRCM determination within 12 months of the end of the relevant financial year.⁴

1.2. Structure of this report

This report outlines the ACCC's final LTRCM determination and view on NBN Co's price compliance for the 2016-17 financial year. The structure of this report is as follows:

- Section 2 describes the LTRCM process
- Section 3 provides an overview of the regulatory information submitted by NBN Co
- Section 4 outlines the ACCC's draft LTRCM determination
- Section 5 summarises the submissions to the draft determination and the ACCC's views on these submissions, and
- Section 6 presents the ACCC's final LTRCM determination and assessment of NBN Co's price compliance for 2016-17.

¹ ACCC, [NBN Co Special Access Undertaking Final Decision](#), 13 December 2013, pp. 11-12.

² Schedule 1F of the SAU.

³ Schedule 1F.3 of the SAU.

⁴ Clause 1E.1.2 of the SAU.

2. LTRCM Process

2.1. Long Term Revenue Constraint Methodology

The LTRCM is a methodology for determining the revenue NBN Co can earn via its prices over the SAU term. In Module 1 of the SAU (the initial regulatory period), the LTRCM occurs on an *ex-post* basis. In Module 2 (the subsequent regulatory period), it occurs on an *ex-ante* basis.

The ACCC must determine the following values (and the inputs to those values) as part of the LTRCM determination:

- annual building block revenue requirement (ABBRR) – the amount of revenue NBN Co is allowed to earn in each financial year
- regulatory asset base (RAB) – the net value of NBN Co's regulated assets, and
- initial cost recovery account (ICRA) – an account for accumulating (and rolling forward) NBN Co's initial unrecovered costs.

We determine NBN Co's RAB and ABBRR based on a range of financial inputs submitted by NBN Co, in accordance with the LTRCM mechanism set out in the SAU.

We use the ABBRR and NBN Co's actual revenue (as defined in the SAU) to calculate the extent of unrecovered costs in each year. The ICRA captures the cumulative value of these unrecovered costs.

Once NBN Co commences earning sufficient revenue each year to meet its annual revenue requirement, the SAU permits NBN Co to recover more than its annual revenue requirement until the ICRA reaches zero (subject to the price controls set out in the SAU).⁵

2.2. ACCC consideration of the LTRCM

The ACCC's role in considering the LTRCM is to:

- assess whether NBN Co's capital expenditure and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR
- assess if the relevant LTRCM components have been calculated in accordance with the formulas set out in the SAU, and
- determine whether the expenditures (as set out in NBN Co's LTRCM proposal) should be included in the LTRCM determination.

The ACCC may determine LTRCM values that are different from the values submitted by NBN Co if those values are determined in accordance with Schedule 1D and Schedule 1E of the SAU.⁶ The factors that the ACCC must consider when determining a substitute amount of capital or operating expenditure are set out in the SAU.⁷

This is the fourth time the ACCC has undertaken then LTRCM determination process. On all previous occasions, the ACCC has accepted NBN Co's proposed values for the LTRCM without modification. The 2013-14 LTRCM determination applied to all years from 2007-08 to

⁵ Clause 1E.6.1 of the SAU

⁶ Clause 1E.1.2(c)(iv) of the SAU

⁷ See clauses 1D.3.2(d) and 1E8.2(c) of the SAU. For example, a substitute amount of capital expenditure determined by the ACCC must meet the Prudent Design Condition and must be consistent with capital expenditure that has been included in the RAB in respect of any prior financial year, having regard to the relative amounts of capital expenditure incurred in those years, the relative cost of goods and services in those years, any relevant differences in the scale and scope of the relevant assets, the NBN Co Corporate Plan and any other matter the ACCC considers relevant.

2013-14. The 2014-15 LTRCM determination included an amendment to the 2013-14 determination to address an inadvertent error by NBN Co in its regulatory information.

2.2.1. Assessment of expenditure

The ACCC must determine as part of its LTRCM assessment, whether NBN Co's capital and operating expenditure both meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR.

Capital expenditure

Capital expenditure may only be included in the RAB to the extent the ACCC is satisfied it meets the Prudent Cost Condition,⁸ the Prudent Design Condition,⁹ or was incurred in connection with the specific matters listed in clause 1D.3.2(a)(ii) of the SAU.

In a broad sense, capital expenditure meets the Prudent Cost Condition if it was incurred in connection with the design, engineering and construction of the relevant assets under a 'conforming contract'¹⁰ (that is, generally, in accordance with NBN Co's procurement rules), or in an open and competitive market, or through another 'value for money' process. The SAU requires that NBN Co's procurement rules contain processes that aim to generate an efficient and competitive outcome and that reflect good industry practice.

Capital expenditure meets the Prudent Design Condition if it is 'materially consistent' with the Network Design Rules¹¹ or a permitted variation, endorsed network change or ACCC approved network change to the Network Design Rules.¹²

The specific matters listed under 1D.3.2(a)(ii) of the SAU are the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmanian tri-area service arrangements, trial sites, third party funded network changes; and expenditure incurred prior to the approval of the SAU on 13 December 2013.¹³

Operating expenditure

Operating expenditure may only be included in the ABBRR to the extent that the ACCC is satisfied it meets certain requirements. These include, that it was: incurred in accordance with NBN Co's procurement processes (including in accordance with the procurement rules); incurred pursuant to a 'conforming contract'; procured in an open and competitive market; procured in a manner that is likely to achieve value for money;¹⁴ or it was incurred in connection with the specific matters specified in clause 1E.8.2(a)(ii) of the SAU.

The specific matters listed under 1E.8.2(a)(ii) of the SAU are: the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmania tri-area service arrangements, trial sites, and third party funded network changes; expenditure incurred prior to the approval of the SAU on 13 December 2013; and expenditure required to address an urgent network issue or a force majeure event.

⁸ Clause 1D.3.2(a)(i)(A) of the SAU.

⁹ Clause 1D.3.2(a)(i)(B) of the SAU.

¹⁰ Clause 1D.4.1(a)(i)(B) of the SAU contains additional requirements where there is a material change of circumstances affecting the conforming contract.

¹¹ This document describes the design of NBN Co's network and network components. Capital expenditure must be in accordance with the Network Design Rules in order to be included in the Regulated Asset Base, in addition to meeting the 'Prudent Cost' condition. The Network Design Rules were updated on 30 June 2017.

¹² Clause 1D.6 of the SAU.

¹³ Schedule 1D of the SAU.

¹⁴ Clauses 1E.8.2(a)(i) and 1E.8.3 of the SAU.

2.2.2. Calculation of LTRCM components

The ACCC's assessment of NBN Co's LTRCM submission also includes checking the inputs and calculations NBN Co has used to determine its proposed values for the LTRCM components. The ACCC must assess whether they have been prepared in accordance with the formulas outlined in the SAU.

NBN Co's submission includes an LTRCM spreadsheet, which sets out the underlying calculations of NBN Co's proposed ABBRR, RAB and ICRA values. The ACCC's checks include confirming that NBN Co has correctly extracted capital expenditure, operating expenditure, construction in progress and revenue from the relevant LTRCM schedules before inputting them into these formulas.

The ACCC must also check two other LTRCM inputs. These include: the cumulative inflation factor which involves taking the cumulative product of the percentage change in June quarter CPI published for each financial year from the commencement of the SAU, relative to the first financial year;¹⁵ and the rate of return used in LTRCM calculations which is the risk free rate of interest with a 350 basis point risk premium.¹⁶

The ACCC then confirms the calculation of the ABBRR, RAB and ICRA values using these inputted values in accordance with the formulas contained in the SAU.

2.2.3. Price compliance and reporting

The SAU sets binding caps on the prices NBN Co can charge its customers. These price controls, together with the LTRCM, provide incentives for NBN Co to incur expenditure efficiently and to price reasonably to promote the long-term interests of end users. The pricing provisions in the SAU include an annual limit on price increases of the Consumer Price Index (CPI) minus 1.5 per cent.¹⁷

NBN Co must submit a Price Compliance Report to the ACCC by 31 October each year. The report includes certification from NBN Co's Chief Financial Officer (CFO) that the prices charged during the preceding financial year did not exceed the maximum regulated prices set by the SAU.

The ACCC may request information from NBN Co at any time reasonably necessary for the ACCC to determine NBN Co's compliance with Schedule 1C of the SAU.

2.3. Consultation process

Under the SAU, the ACCC is required to undertake a number of steps in making an LTRCM determination.

On 21 December 2017, the ACCC provided its preliminary view to NBN Co that it does not intend to determine a substitute amount of capital expenditure in accordance with clause 1D.3.2(d) or a substitute amount of operating expenditure in accordance with clause 1E.8.2(c) of the SAU. The ACCC's preliminary view is available on the ACCC website.¹⁸

¹⁵ Clause 1E.9.4(b) of the SAU.

¹⁶ Clause 1E.7.1 of the SAU.

¹⁷ Schedules 1C.5 and 2B.2 of the SAU.

¹⁸ See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2016-17>

On 27 April 2018, the ACCC published the 2016-17 LTRCM draft determination. The ACCC's draft determination is available on the ACCC website.¹⁹ The ACCC invited submissions on the draft determination until 25 May 2018. The ACCC received submissions from Telstra, NBN Co and Optus.

The ACCC is required to make the LTRCM determination for 2016-17 by 30 June 2018.

¹⁹ See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2016-17>

3. NBN Co's 2016-17 regulatory information

On 31 October 2017, NBN Co submitted an LTRCM proposal to the ACCC for 2016-17 (the regulatory information). NBN Co's regulatory information consists of NBN Co's actual and proposed financial information, an Expenditure Compliance Report, a Procurement Compliance Report, and a Price Compliance Report.

NBN Co has also submitted three independent reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, an LTRCM spreadsheet and a copy of its Chart of Accounts. The ACCC has published public versions of NBN Co's regulatory information on the ACCC website.²⁰

3.1. Expenditure compliance

NBN Co's regulatory information included an Expenditure Compliance Report for 2016-17, pursuant to clause 1F.2.1(a) of the SAU. This report contains certification from NBN Co's CFO that NBN Co's proposed capital and operating expenditure complies with the relevant expenditure conditions set out in the SAU.

As in previous years, NBN Co engaged PwC to perform an independent limited assurance review in relation to the design of controls applicable to capital and operating expenditure prudence. PwC's report expresses an unqualified opinion and complements the certification from NBN Co's CFO.

In its regulatory information, NBN Co submitted a Procurement Rules Compliance Report in accordance with clause 1F.2.3(a) of the SAU. The report contains a certification from NBN Co's Executive General Manager (EGM) Procurement²¹ that NBN Co has developed and maintained Procurement Rules that satisfy the relevant conditions in clause 1D.5.1 of the SAU.

3.2. Financial information

In its regulatory information, NBN Co submitted its actual and proposed financial information for the 2016-17 financial year. This submission consisted of the following six schedules:

- Schedule 6 – Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes
- Schedule 7 – Statement of Operating Expenditure
- Schedule 8 – Statement of Interest Expense
- Schedule 9 – Statement of Revenue
- Schedule 10 – Statement of LTRCM and RAB items, and
- Schedule 11 – Statement of Material Operating Expenditure, Capital Expenditure and Construction in Progress Variances.

NBN Co also submitted an LTRCM spreadsheet, which sets out the underlying calculations of NBN Co's proposed ABBRR, RAB and ICRA values.

²⁰ See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2016-17>

²¹ NBN Co's EGM Procurement is the successor to the NBN Co's Chief Procurement Officer role at NBN Co. In NBN Co's 2015-16 LTRCM submission, the Procurement Rules Compliance Report was signed by NBN Co's CFO, being a person responsible for the performance of the Chief Procurement Officer function of NBN Co. For the 2013-14 and 2014-15 LTRCM submissions, the report was signed by the Chief Procurement Officer.

We have summarised the key financial information submitted by NBN Co for the 2016-17 LTRCM determination in Table 3.1 below. The table also shows the corresponding values for the 2015-16 LTRCM determination and the percentage change for comparison purposes.

Table 3.1: Summary of NBN Co's financial information, 2015-16 and 2016-17 (nominal)

	2015-16 (\$'000)	2016-17 (\$'000)	Percentage change
Operating expenditure	2 259 775	3 726 986	65%
Capital expenditure	4 523 444	6 026 916	33%
Construction in progress (start of period)	3 482 834	3 991 030	15%
Interest expense	247	5	-98%
Revenue	421 455	1 001 002	138%
Unrecovered costs	2 777 273	4 056 114	46%
RAB (end of period)	8 944 763	14 369 643	61%
ABBRR	3 198 728	5 057 117	58%
ICRA (end of period)	9 428 175	14 014 956	49%

Source: LTRCM spreadsheet 2016-17

NBN Co also lodged two independent assurance reports from PwC to support its actual and proposed financial information submissions. This includes:

- a reasonable assurance audit report for Schedules 6 to 9: PwC's opinion in this report was unqualified and complements the audit of NBN Co's general purpose financial statements, and
- a factual findings of agreed upon procedures report for Schedule 10: PwC checked that the relevant values for previous years were in accordance with the 2015-16 LTRCM determination, that the relevant input values for 2016-17 were correctly extracted from Schedules 6 to 9 into the LTRCM spreadsheet, and that the relevant LTRCM calculations were undertaken in accordance with the SAU.

3.3. Price compliance reporting

In its regulatory information, NBN Co submitted a Price Compliance Report and a price compliance spreadsheet for the period from 1 July 2016 to 30 June 2017.²²

In previous years, NBN Co has also lodged an independent assurance report by PwC on the effectiveness of its control procedures to ensure price compliance. As part of this year's LTRCM submission, NBN Co did not seek independent assurance work from PwC for price compliance. The ACCC agrees with this approach in line with the reasons presented by NBN Co in its LTRCM supporting submission: there is limited (if any) ongoing utility in such work as NBN Co's price compliance is observable by access seekers throughout the financial year, through the publication of changes to the price lists on NBN Co's website. The ACCC considers that the independent assurance work is not necessary this year, but we note that there are provisions in the SAU that allow us to seek additional assurance in future years if required.

²² Pursuant to clause 1F.3(a) of the SAU.

4. Overview of ACCC's draft determination

On 27 April 2018, the ACCC published the 2016-17 LTRCM draft determination.

The ACCC's draft determination proposed to accept NBN Co's proposed values (and inputs to the values) for the ABBRR, RAB and ICRA. The draft determination set out the ACCC's detailed assessment of NBN Co's regulatory information, which was submitted under Schedule 1F of the SAU. The ACCC's draft view was that:

- NBN Co had incurred capital and operating expenditure in accordance with the relevant provisions of the SAU
- NBN Co's proposed LTRCM values had been calculated in accordance with Schedules 1D and 1E of the SAU, and
- NBN Co's prices had not exceeded the maximum regulated levels set out in Schedule 1C of the SAU.

This section summarises the ACCC's draft determination

4.1. Expenditure compliance and reporting

4.1.1. Expenditure compliance

The ACCC assessed NBN Co's expenditure compliance by considering the Expenditure Compliance Report signed by NBN Co's CFO, PwC's limited assurance reports and NBN Co's supporting submission. The ACCC's draft decision was that NBN Co's expenditure has complied with the relevant prudency conditions in the SAU.

The Expenditure Compliance Report did not identify any exceptions during the 2016-17 financial year. However, the report is subject to some qualifying language and expresses a negative assurance conclusion. The ACCC therefore considered NBN Co's other supporting materials to determine the extent that it could rely on the certification.

The ACCC checked that NBN Co's Procurement Guidelines complied with the relevant provisions of the SAU, as well as considering NBN Co's Procurement Rules Compliance Report to determine whether NBN Co had developed appropriate procurement rules.

The ACCC considered PwC's limited assurance report on the design of controls for expenditure compliance to determine whether there are processes and controls in place to support compliance with the prudency conditions in the SAU. The PwC report expresses an unqualified limited assurance conclusion.

The ACCC also considered NBN Co's supporting submission, which outlines its internal audit work, in order to assess whether NBN Co complied with these processes and controls.

Further information regarding NBN Co's procurement processes

The ACCC sought further information from NBN Co as part of the 2015-16 LTRCM process, regarding NBN Co's procurement processes to improve the ACCC's understanding of how NBN Co complies with the prudency requirements in the SAU.

NBN Co provided information to the ACCC in response to these requests, including through a procurement briefing given by NBN Co's procurement team to the ACCC.

The ACCC considered that the material provided by NBN Co satisfied its requirement that appropriate procedures and processes exist to ensure its expenditures are in accordance

with the prudence conditions set out in the SAU and that these processes are operating effectively.

The understanding gained during this process assisted the ACCC in considering NBN Co's submission and making its draft decision for the 2016-17 LTRCM process. We considered that it was appropriate to use this information to inform our decision this year as NBN Co's procurement involves a combination of short and long-term contracts, so a considerable amount of this information will still be applicable this year. As such, we did not request a procurement briefing this year but we may seek additional briefings in future years to further assist our understanding.

4.1.2. Procurement compliance

The ACCC considered that NBN Co had provided a Procurement Rules Compliance Report that meets the requirements of the SAU.

The Procurement Rules Compliance Report did not identify any exceptions for the 2016-17 financial year. The Procurement Rules Compliance Report includes some qualifying language and expresses negative assurance conclusions. The ACCC also considered the material in NBN Co's supporting submission outlining what has informed the EGM Procurement's certification.

Based on this consideration, the ACCC is satisfied with NBN Co's procurement compliance for the purposes of the LTRCM determination.

4.2. Financial information

The ACCC considered NBN Co's regulatory information and considered that NBN Co had calculated its proposed values for the RAB, ABBRR and ICRA in accordance with the formulas in Schedules 1D and 1E of the SAU. Therefore, the ACCC's draft decision was to accept NBN Co's proposed values for the RAB, ABBRR and ICRA without amendment.

The ACCC considered NBN Co's actual and proposed financial information in assessing whether NBN Co had calculated its proposed LTRCM values in accordance with Schedules 1D and 1E of the SAU. The ACCC also had regard to NBN Co's LTRCM spreadsheet, which sets out the inputs and calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA. In making its draft decision, the ACCC reviewed the calculations NBN Co submitted in its LTRCM spreadsheet and confirmed that the formulas used in the spreadsheet were as set out in Schedule 1E of the SAU.

Further, the ACCC considered the independent assurance reports from PwC and the statement of material variances, which support NBN Co's financial reporting.

The declaration provided by NBN Co's CFO and the independent assurance reports from PwC provide the ACCC with assurance that NBN Co's financial information has been prepared in accordance with the relevant provisions of the SAU.

NBN Co's regulatory information included a statement of material variances (Schedule 11), in accordance with clause 1F.1.3(b) of the SAU. The ACCC has reviewed Schedule 11 and is satisfied that it does not raise any significant concerns regarding the magnitude of capital and operating expenditure.

4.3. Price compliance

The ACCC considered NBN Co's Price Compliance Report and its supporting submission. The ACCC was satisfied that NBN Co's prices in 2016-17 did not exceed the maximum regulated prices set out in Schedule 1C of the SAU.

The ACCC undertook analysis of the price compliance spreadsheet submitted by NBN Co. We reviewed the prices listed in the spreadsheet and compared them to Schedule 1C of the SAU. We did not find any instances in which the listed prices exceeded the applicable maximum regulated prices.

We noted that the price compliance spreadsheet contains several new prices that NBN Co introduced in 2016-17.²³ The SAU does not specify a maximum regulated price for these products. We recognise that NBN Co has the ability to set prices for new products under the SAU. However, we also noted that the ACCC has the ability to initiate a price review to ensure that new prices are set in a way that promotes competition and the efficient use of the network, if we consider that this would be appropriate.²⁴

The ACCC was satisfied that NBN Co's Price Compliance Report and supporting submission provide assurance that NBN Co has key control procedures in place to ensure that the prices for NBN Co's products do not exceed the applicable maximum regulated prices. Our analysis of the price compliance spreadsheet supported this conclusion. Therefore, the ACCC was satisfied that NBN Co has met its price compliance obligations in the SAU.

²³ These new prices relate to new ancillary services and additional features for existing products.

²⁴ Schedule 1G of the SAU.

5. Submissions to the ACCC's draft determination

The ACCC received three submissions in response to the draft determination. These consisted of a submission from Telstra and cross-submissions from Optus and NBN Co.

5.1. Stakeholder submissions

Telstra's submission did not comment specifically on the ACCC's LTRCM draft determination for 2016-17 or NBN Co's compliance with the applicable price controls under the SAU. However, Telstra raised two key issues that it considers are relevant to the LTRCM review:

- the classification of NBN Co's recently introduced product bundles as 'discounts' under the SAU rather than 'new offers', and
- the treatment of build costs in the LTRCM for new trial infrastructure and enterprise ventures undertaken by NBN Co.²⁵

Optus provided a submission supporting the concerns raised by Telstra and, in particular, the uncertainty over whether the bundled product offers, introduced by way of discounts, will be available going forward on a long-term basis. NBN Co provided a submission in reply, addressing the concerns raised by Telstra.

Telstra and Optus argue that the introduction of the new high bandwidth product bundles as 'discounts' rather than 'new offers' has important implications for RSPs and end-users. Under the SAU, 'new offers' are subject to the annual CPI minus 1.5 per cent price controls and provisions relating to the withdrawal of products, which includes the ability of the ACCC to reject product withdrawals and notice provisions. On the other hand, 'discounts' can be removed at NBN Co's discretion. Telstra and Optus submit that this creates significant uncertainty and potential price shocks for RSPs and their customers. Telstra and Optus consider that the new product bundles should be more appropriately classified as 'new offers' under the SAU and note differences between the bundled products and the NBN offers.²⁶ Telstra also notes that the SAU is silent on whether a new offer should be treated as an NBN offer or a discount. It has requested the ACCC provide guidance as to the classification of NBN Co offers, and, in particular whether the new bundles will be treated as NBN offers.

NBN Co submits that the high bandwidth bundles are discounts offered in relation to existing product components and product features and that there is no change to the price structure established by the WBA and SAU. NBN Co argues that the high bandwidth bundles cannot constitute NBN offers under the SAU and identify a number of factors in support of its view. NBN Co also notes that the SAU contemplates the way discounts may be offered and how they interact with the maximum regulated price. NBN Co further argues that if the high bandwidth bundles constituted NBN offers for the purposes of the SAU, then there would be two or more maximum regulated prices for the same underlying product feature, which is not contemplated by the SAU and SAU price compliance would become complicated.²⁷

In their submissions, Telstra and Optus also queried how expenditure undertaken by NBN Co for trials and for enterprise customers should be treated under the SAU and for the

²⁵ Telstra, *Submission to long term revenue constraint methodology 2016-17: Draft determination and price compliance reporting 2016-17*, 25 May 2018, p.1.

²⁶ Telstra, *Submission to long term revenue constraint methodology 2016-17: Draft determination and price compliance reporting 2016-17*, 25 May 2018, pp.1-3; Optus, *Submission to 2016-17 LTRCM determination consultation*, 7 June 2018, pp.1-2.

²⁷ NBN Co, *Submission to Long Term Revenue Constraints Methodology 2016-17: Draft Determination and Price Compliance Report 2016-17*, 4 June 2018, pp.1-2.

purposes of the LTRCM.²⁸ NBN Co submits that the SAU specifically permits all expenditure incurred by NBN Co in connection with NBN Co's networks, network elements and other related assets to be included in the LTRCM calculations if that expenditure meets the prudency conditions set out in the SAU.²⁹

5.2. ACCC views

The ACCC notes that neither Telstra nor Optus' submissions include comments relating to the 2016-17 LTRCM determination. Further, the matters raised in each submission about the use of discounts relate to recent pricing initiatives announced by NBN Co and implemented after the period relevant to this determination. However, ACCC's views on these issues are set out below.

The ACCC notes that Module 1 of the SAU allows NBN Co some pricing flexibility, such as using discounts, which can deliver allocative and productive efficiency benefits. In June 2016, NBN Co implemented dimension-based discounts under these provisions, which had the benefit of speed and flexibility. While NBN Co has consulted with industry on the method for delivering the High Bandwidth Bundles through discounts, the matters raised by Telstra and Optus require further consideration.

Implementation of bundled offers

Telstra and Optus argue that by introducing the High Bandwidth Bundles by way of a discount, rather than as an NBN offer, the products are not subject to the price controls and price review mechanisms set out in the SAU. They submit that this approach can disadvantage RSPs and end users as uncertainty about wholesale prices will affect competition in downstream markets. Telstra notes that as RSPs often contract with customers for extended periods, such as twelve or twenty-four months, and discounts can be withdrawn with limited notice, this approach essentially shifts the pricing risk to RSPs.

NBN Co on the other hand, points to the speed and flexibility with which discounts can be implemented which has a positive influence on downstream competition. It also points to the SAU provisions about maximum regulated prices, which would create more uncertainty and complexity had NBN Co introduced the bundled products as new offers.

Given these matters do not relate directly to the 2016-17 LTRCM Determination, the ACCC proposes to further consider the matters raised in submissions. The ACCC agrees that further guidance to NBN Co and industry is required to provide more certainty about the characterisation of bundled products under the SAU. The ACCC will shortly re-commence its assessment of the SAU Variation, which was paused in October 2017 to allow NBN Co to progress its pricing initiatives. These matters may be considered in that process or on a standalone basis after further consultation with Telstra, Optus, NBN Co and other parties if necessary.

Treatment of costs and revenues of certain NBN services

The second issue raised by Telstra and Optus, regarding the treatment of costs and revenues of certain NBN services, is relevant to the LTRCM process generally. The ACCC agrees with NBN Co that under the SAU, all expenditure and revenues associated with NBN networks is included for the purposes of the LTRCM.

²⁸ Telstra, *Submission to long term revenue constraint methodology 2016-17: Draft determination and price compliance reporting 2016-17*, 25 May 2018, p.4.; Optus, *Submission to 2016-17 LTRCM determination consultation*, 7 June 2018, p.2.

²⁹ NBN Co, *Submission to Long Term Revenue Constraints Methodology 2016-17: Draft Determination and Price Compliance Report 2016-17*, 4 June 2018, pp.2-3.

However, the ACCC agrees that an appropriate level of scrutiny over NBN Co's costs in relation to the roll out of infrastructure through the LTRCM process is essential, particularly as NBN Co enters competitive markets. It is important that NBN Co is not able to use its position as a provider of regulated services to obtain an advantage in the supply of services in competitive markets.

The ACCC will monitor developments in this area and will consider the need for any additional tracking of costs and revenues, subject to the existing provisions under the SAU if it considers it appropriate to do so. The ACCC will consult with Telstra, NBN Co and Optus and other parties where necessary on this matter, as part of future LTRCM processes.

5.3. LTRCM decision

The ACCC did not receive any submissions relating to the proposed acceptance of NBN Co's proposed values for the RAB, ABBRR and ICRA or the decision on NBN Co's price compliance for 2016-17. Accordingly, the ACCC maintains the views set out in its draft LTRCM determination. The ACCC's final LTRCM determination for 2016-17 is to accept NBN Co's proposed values (and the inputs to those values) for the ABBRR, RAB, and ICRA without modification, in accordance with clause 1E.1.2 of the SAU. Regarding price compliance, the ACCC is satisfied that NBN Co's prices for 2016-17 did not exceed the applicable maximum regulated prices in accordance with Schedule 1C of the SAU.

6. The ACCC's LTRCM final determination

The ACCC has determined the values in Table 6.1 for the purposes of the 2016-17 LTRCM Determination. We have derived these values from the regulatory information provided by NBN Co.³⁰

The ACCC is also satisfied that NBN Co's prices for 2016-17 did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with schedule 1C of the SAU.

Table 6.1: 2016-17 LTRCM Draft Determination³¹

Year	2016-17
CPI and Cumulative Inflation Factor	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	1.934%
Cumulative Inflation Factor – as per Clauses 1E.9.4(b) and (c)	1.045
Rate of Return – as per Clause 1E.7.1	
Risk free rate of interest – as per Clause 1E.7.1(b) and (c)	2.129%
Nominal rate of return – as per Clause 1E.7.1(a)	5.629%
Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1	
Real RAB (start period) – as per Clause 1D.2.1(a) and (b)	8 722 380
Real capital expenditure	5 765 586
Real disposals	-
Real straight line depreciation	741 397
Real RAB (end period) – as per Clause 1D.2.1(b)	13 746 569
Regulatory Asset Base (\$'000 NOMINAL) – as per Clause 1D.2.2	
Nominal RAB (start period) – as per Clauses 1D.2.1(a) and 1D.2.2	8 944 763
Nominal straight line depreciation (as per Clause 1E.9.1(b))	775 001
Nominal RAB (end period) – as per Clause 1D.2.2	14 369 643
ABBRR (\$'000 NOMINAL) – as per Clause 1E.4.1	
Return on capital	503 458
Nominal regulatory depreciation – as per clause 1E.9.1(c)	602 036
Nominal operating expenditure	3 726 986
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	224 636
ABBRR	5 057 117

³⁰ In accordance with Clause 1E.1.2(c)(vi) of the SAU.

³¹ The clause references in this table refer to the formulas in the SAU.

Taxation calculations (\$'000 NOMINAL) – as per Clause 1E.9.3	
Nominal revenue	1 001 002
<i>Add</i> value of assets received for nil consideration	129 447
<i>Less</i> nominal operating expenditure	3 726 986
<i>Less</i> nominal tax depreciation	760 053
<i>Less</i> interest expense	5
Taxable profit – as per Clause 1E.9.3	(3 356 595)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(6 944 456)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(10 301 051)
Net tax allowance – as per Clause 1E.9.3	-
ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5	
ICRA (start period) – as per Clause 1E.5.2	9 428 175
Unrecovered cost – as per Clause 1E.5.1	4 056 114
ICRA (end period) – as per Clause 1E.5.2	14 014 956
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a