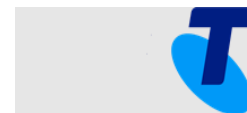




TELSTRA GROUP LIMITED

Telstra submission – NBN Co Cost Allocation Manual (November 2023) ACCC Consultation Paper

25 January 2024



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Executive Summary

The revised CAM represents an improvement over the previous iteration. The CAM addresses several of the issues raised by stakeholders in November 2022, and we support the revised approach to the allocation of operational costs and the increased transparency on shared costs.

NBN Co. has defined its three competitive services: Enterprise Ethernet, Business Satellite Services and Satellite Mobility for Large Commercial Passenger Aircraft, whilst all other NBN services are categorised as core services, which could still result in over allocated costs to core services.

Telstra welcomes the increased detail on the breakdown of shared operating expense categories and their causal relationships. The use of allocators based on each cost category as opposed to a blanket allocation based on revenue proportions provides a more efficient approach.

There is still a transparency gap in how the cost allocators will work which we believe needs to be addressed to assist in determining whether they are fully appropriate and prevent cross subsidisation between monopoly and competitive services.

Telstra is concerned that NBN Co is also targeting competitive business connectivity and by lowering prices on their high end 1000/400 and 500/200 plans, they are artificially shifting enterprise grade customers to what NBN has self-defined as a “Core” service.

Telstra believes that there needs to be greater assurance from NBN Co that there are adequate safeguards to prevent cross subsidisation of costs from monopoly services to its competitive services.



1 Is the proposed CAM consistent with the cost allocation principles in NBN Co's SAU?

Telstra has raised its concerns regarding the NBN SAU cost allocation principles, most recently in its February 2023 submission¹. Under the existing SAU there is no constraint on the ACCC's ability to allocate NBN Co's costs between core and non-core services. The SAU would give the ACCC the ongoing ability, and the responsibility, to determine whether NBN Co's cost allocations are in the Long-Term Interests of End-Users (LTIE). For the ACCC to exercise this responsibility, NBN Co should be required to publish in its Cost Allocation Manual (CAM) all inputs, methodologies and outputs associated with its cost allocations, and be required to demonstrate the following:

- All costs allocated to core are central to its core wholesale business and exclude items such as marketing and P&A to retail customers.
- All Capex and Opex is allocated on a project basis to the services and end users that benefit from that Capex and Opex.
- Services and end users that are not intended to benefit from a project's Capex and Opex are not allocated its cost (to prevent cross subsidisation at the time of the spend and for the life of the project); and,
- The allocation of costs to core services does not insure NBN Co's risky non-core investments.

2 Does the proposed CAM address the issues identified above raised by stakeholders regarding the draft indicative CAM submitted by NBN Co as part of its SAU variation proposal in November 2022?

Whilst NBN Co's proposed CAM does address several issues raised by stakeholders as part of its SAU variation proposal in November 2022, Telstra believes that there are still issues that NBN Co needs to address. NBN Co has revised its approach to allocation of operational costs and has provided more transparency on shared costs, which was a common issue raised by the Retail Service Providers (RSPs) and other stakeholders in their initial CAM proposal in November 2022². NBN has provided further detail on a breakdown of shared operating expense categories, their causality relationships and identified more appropriate allocators based on each cost category as opposed to a blanket allocation based on revenue proportions, providing a more efficient approach.

Despite defining three competitive services: Enterprise Ethernet, Business Satellite Services and Satellite Mobility for Large Commercial Passenger Aircraft, there is still a blanket definition for NBN Co's core services³. Essentially, all other NBN services, including all residential grade services, are categorised as core services. This could possibly result in an over-allocation of costs to its core services.

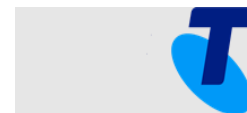
The CAM should be more specific than defining core services as all services supplied by NBN Co other than the three competitive services. The definition of core services is too broad and provides NBN Co with an umbrella protection against future regulatory intervention in relation to any services that might "fall through the cracks". Instead, the CAM should specify the core services provided by NBN Co, thereby providing greater clarity on where core service costs are being allocated.

It should be made clear in the CAM how the Initial Cost Recovery Account (ICRA) has been allocated between competitive and core services. Whilst Telstra appreciates that the approved SAU Variation sets out the amount of and application of a Core ICRA and the Building Block Model (BBM) calculates a Core Services ICRA and a competitive ICRA allocation, this should be provided in the CAM.

¹ [Telstra submission in relation to NBN's proposed SAU variation, February 2023, section 2.6](#)

² [NBN Co SAU variation \(November 2022\)](#)

³ [NBN Cost Allocation Manual, November 2023, Section 2.1](#)



A proportion of the ICRA should be allocated to non-core services. It is unreasonable for NBN Co to load the full burden of reducing its debt or achieving a standalone credit rating on core services, whilst earning a profit from non-core services.

3 Does the proposed CAM provide sufficient detail to provide transparency over how costs are allocated between NBN Co's monopoly and competitive services?

NBN Co has revised its approach to allocation of operational costs and has provided a greater level of transparency on shared costs, which was a common issue raised by the RSPs and other stakeholders in response to the initial CAM in November 2022. NBN Co has provided further detail on the breakdown of shared operating expense categories, their causality relationships and more appropriate allocators based on each cost category as opposed to a blanket allocation based on revenue proportions. Whilst Telstra agrees there has been some progress on transparency over cost allocations there remain some issues regarding the transparency of allocation between monopoly and competitive services including:

- The CAM should be more specific than defining core services as all services supplied by NBN Co other than the three competitive services.
- The reclassification of services can only be dealt with by a Replacement Module Application or an ACCC Replacement Module Determination, potentially once every five years. This is likely to be too infrequent to prevent harm that might arise from the misclassification of services and determining the appropriate cost allocations.
- NBN Co should be transparent on how the shared cost allocators will work.
- NBN Co should have adequate safeguards to prevent cross subsidisation of costs from monopoly services to its competitive services.

4 Is the cost allocation methodology in the proposed CAM and its approach to allocators for costs directly attributable to and shared between NBN Co's monopoly and competitive services consistent with the economic principles of efficient cost allocation?

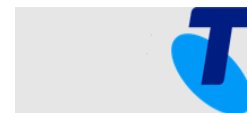
NBN Co has revised its approach to the allocation of operational costs and has provided greater transparency on shared costs, which is more consistent with the principles of efficient cost allocation than has previously been the case. NBN Co has provided further detail on the breakdown of shared operating expense categories, their causality relationships and provided more appropriate allocators based on each cost category as opposed to a blanket allocation based on revenue proportions⁴. This aligns with the principles of efficient cost allocation,

On face value, it appears NBN Co's selection of causal allocators (and where there are no direct causal allocators, to adopt a relevant alternative) are appropriate. NBN Co has also adhered to the SAU Clauses 2.c.6.2(d) and 2.c.6.2 (e) whereby all costs will be allocated, and no costs will be allocated more than once. Additionally, NBN has improved the level of transparency provided in comparison to their November 2022 CAM.

Whilst Telstra welcomes this as a positive outcome, there still needs to be increased transparency on how the cost allocators will work. As mentioned in Telstra's February 2023 submission response, there has been no publication of:

- What proportions of individual capex and opex items have been allocated to core regulated services.

⁴ [nbn Supporting Submission: Proposed Cost Allocation Manual](#), November 2023



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- Details of major capital projects underlying a substantial increase in claimed costs, including the impact on take-up and service quality, the costs, and the economic return.

This will assist in determining whether they are fully appropriate and prevent cross subsidisation between monopoly and competitive services.

5 Does the proposed CAM mitigate the risk of NBN Co cross subsidising its competitive services from its monopoly services?

As stated in Telstra's February 2023 submission on the nbn SAU⁵, we believe that NBN Co still has a strong incentive to overbuild competitive infrastructure and focus on its non-core activities. Telstra acknowledges that NBN Co has adopted greater transparency and efficiency in its cost allocation methodology, however we still have concerns regarding the risk that NBN Co will recover losses in its core services by expanding into competitive markets.

Telstra reiterates that even with the proposed changes to the CAM it will still be difficult for industry and the ACCC to regularly monitor NBN Co's cost allocation and seek changes when they are required out to 2040. Further to this, there is still little exposure to public scrutiny of NBN Co's cost allocation outcomes, further limiting the ability of industry and the regulator to monitor the allocation of costs⁶.

Given that NBN Co is still struggling to improve its core business and improve broadband service quality benchmarks, the focus of NBN Co should be on core activities. NBN Co should not overbuild competitive infrastructure or invest in non-core investments that increase its exposure to risk that would reduce its ability to efficiently recover costs. The concerns raised in our 2023 submission on NBN Co's proposed SAU variation in relation to outputs associated with its cost allocation remain.

In NBN Co's most recent 3-year pricing roadmap submitted in November 2023, NBN Co is heavily reducing prices of their higher end plans including 250/100, 500/200 and 1000/400. Coupled with issuing rebates to incentivise take-up on their highest speed tiers (Ultrafast and 1000/400), NBN Co is evidently targeting competitive business connectivity. This could result in artificially shifting enterprise grade customers to what NBN Co has self-defined as a "Core" service. As a result, the capital investment of these significantly high upload speed plans, which are more favoured by Enterprise grade and business connectivity customers, will be recovered by core customers on the consumer grade 50 and 100 plans. NBN Co appear to have self-defined what is deemed a competitive versus core service.

There needs to be assurance from NBN Co that it has put in place adequate safeguards to prevent cross subsidisation of costs from monopoly services to its competitive services. The optimum way to ensure this is for the ACCC to ensure that NBN Co has fully distributed shared costs and does not engage in cross-subsidisation.

6 Does the proposed CAM incorporate appropriate governance and accountability arrangements for application of the CAM and internal compliance, periodic review and updating within NBN Co?

Telstra agrees that the proposed CAM does incorporate suitable governance and accountability for application of the CAM. The provision of an annual review of cost allocation percentages and cost categorisations to determine whether they are directly attributable or shared, provides an appropriate level of oversight.

⁵ [Telstra Submission in relation to NBN's proposed SAU variation, February 2023](#), section 2.6.

⁶ [Ibid.](#) section 2.6.1



7 Is the proposed CAM consistent with best practice regulation of other utility businesses, with respect to transparent cost allocation arrangements where a regulated business operates in both monopoly and competitive markets?

Adopting the CAM regulatory framework used by the AER should provide industry and the ACCC with greater transparency in relation to NBN Co cost allocations than previously provided by NBN Co. However, Telstra still has concerns regarding the level of detail provided by NBN Co in the proposed CAM and whether it fully addresses concerns raised in our previous submissions⁷.

The cost allocation documentation that Chorus is required to provide is more comprehensive than that provided by NBN Co, recognising that Chorus does not have the same degree of crossover into competitive markets as NBN. This documentation consists of 248 pages of detailed cost allocation inputs, methodology and outputs. NBN Co proposes to provide its methodology and cost allocation measures as part of its revised CAM, however by comparison it is documented in just 23 pages⁸.

The Farriersweir report outlined the cost and asset allocations approach used by Chorus, which is more comprehensive than that proposed by NBN Co⁹. To illustrate this point, Chorus allocates approximately 100 Opex categories, using around 50 allocation drivers. NBN by contrast disaggregates separately allocated cost groups to 56 groups and adopts 11 unique causal allocators¹⁰.

Whilst Telstra acknowledges that NBN Co's revised CAM is moving in the right direction, we still have concerns regarding whether industry best practices are being implemented in relation to its allocation of costs between its monopoly and competitive markets. Telstra suggests that NBN Co consider whether the approach to cost allocation adopted by Chorus is more appropriate for a telecommunications provider.

⁷ [Ibid](#)

⁸ [Analysys Mason on behalf of Chorus, 2022](#)

⁹ [Farrier Swier Report, 2023 Appendix B p24](#)

¹⁰ [Ibid](#)