



**NBN Co Special Access Undertaking**

**Long Term Revenue Constraint  
Methodology 2013-14: Draft Determination**

**and**

**Price compliance reporting 2013-14**

**February 2015**



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## List of abbreviations

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
CCA	<i>Competition and Consumer Act 2010</i> (Commonwealth)
CFO	Chief Financial Officer
CIP	Construction in Progress
CPI	Consumer Price Index
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
NBN	National Broadband Network
PDF	Product Development Forum
RAB	Regulatory Asset Base
SAU	Special Access Undertaking
SFAA	Standard Form Access Agreement
WBA	Wholesale Broadband Agreement

## **Executive Summary**

On 13 December 2013, the Australian Competition and Consumer Commission (ACCC) accepted a Special Access Undertaking (SAU) from NBN Co. The SAU establishes part of the regulatory framework for the National Broadband Network (NBN).

Schedule 1F of the SAU requires NBN Co to submit certain regulatory information for each financial year, including financial information required to determine the revenues NBN Co is allowed to earn (its long term revenue constraint) and certify that it has complied with the price controls set out in the SAU.

### **Long Term Revenue Constraint Methodology (LTRCM) Draft Determination**

The ACCC must make a Long Term Revenue Constraint Methodology (LTRCM) Draft Determination for the 2013-14 financial year under clause 1E.1.2(c)(vi)(A) of the SAU. This is the first time the ACCC is making an LTRCM Determination under the SAU.

The LTRCM is a mechanism for determining the amount of revenue NBN Co is allowed to earn via its prices over the term of the SAU. The LTRCM gives NBN Co the opportunity to recover its prudent and efficient costs of supply and creates an incentive for NBN Co to operate prudently and efficiently.

In making an LTRCM Determination, the ACCC must determine the following values (and the inputs to the values):

- Annual Building Block Revenue Requirement (ABRR)—this is the amount of revenue NBN Co is allowed to earn for each financial year
- Regulatory Asset Base (RAB)—this is the net value of NBN Co's regulated assets
- Initial Cost Recovery Account (ICRA)—this is an account for accumulating (and rolling forward) NBN Co's initial unrecovered costs.

During the initial period of the SAU, while the NBN is being rolled out, the ACCC's role in making an LTRCM Determination is to determine capital expenditure and operating expenditure which meet the relevant SAU provisions, for inclusion in the RAB and ABRR, respectively. If the ACCC is not satisfied that NBN Co has incurred its expenditure in accordance with the SAU provisions, including the prudence criteria set out in the SAU, the ACCC can determine substitute values in its LTRCM Determination. This process differs from price determinations for other regulated businesses where allowed revenues and regulated prices are based on an ACCC/AER assessment of the prudence and efficiency of the regulated businesses' forecast expenditures.

In accordance with its obligations under the SAU, on 31 October 2014 NBN Co submitted to the ACCC a set of regulatory information for 2013-14 and certain historical financial information for prior years. NBN Co subsequently updated some of this information in its supplementary submission to the ACCC on 8 December 2014. These submissions are collectively referred to as the LTRCM proposal in this report.

In making this Draft Determination, the ACCC has checked that:

- NBN Co's financial details are consistent with its statutory accounts and the formulas and definitions in the SAU
- NBN Co has procedures and processes to ensure that its expenditures are in accordance with the prudence criteria in the SAU and there is sufficient evidence that NBN Co complied with these processes and procedures.

In assessing NBN Co's expenditure, the ACCC has considered the Expenditure Compliance Report signed by NBN Co's Chief Financial Officer (CFO), supporting audit reports from PricewaterhouseCoopers (PwC), NBN Co's supporting submission of 31 October 2014, and the supplementary submission provided by NBN Co on 8 December 2014. The ACCC considers that the PwC audit reports provide independent verification that the LTRCM proposal accurately reflects NBN Co's annual statutory accounts, and NBN Co's supporting and supplementary submissions demonstrate that NBN Co has procedures and processes in place to allow it to comply with the Prudency Conditions and Procurement Rules set out by the SAU. The ACCC considers this approach to assessing NBN Co's LTRCM proposal is appropriate in the current circumstances, noting that a large proportion of NBN Co's expenditures in its first LTRCM proposal are specified to be prudent under the SAU.

The ACCC may adopt a different approach in future if it considers it appropriate to do so, and notes that the ACCC has flexibility under the SAU in how it undertakes its assessment of NBN Co's regulatory information.

The ACCC's draft decision is that NBN Co's LTRCM proposal satisfies the requirements set out in the SAU. In this LTRCM Draft Determination, the ACCC proposes to accept NBN Co's proposed values for the ABBRR, RAB and the ICRA. The ACCC also proposes to accept NBN Co's proposed inputs to these values, including its operating and capital expenditures, financing costs and revenues (discussed in chapter 4 of this report). The ACCC has accepted NBN Co's exclusion of interest income on unspent equity injections in calculating regulated revenue, noting that these equity injections are not rolled into the RAB until they are spent and NBN Co does not receive a regulated rate of return on these equity injections until then.

The ACCC seeks stakeholder views on the LTRCM Draft Determination until 5pm on **Friday 27 March 2015**.

### **Price compliance reporting**

Under Schedule 1F.3 of the SAU, NBN Co is required to provide certain price compliance information to the ACCC to demonstrate that it has not exceeded the maximum regulated prices set by Schedule 1C of the SAU.

The ACCC has considered the Price Compliance Report signed by NBN Co's CFO, the PwC assurance report on NBN Co's internal controls in relation to price compliance, and NBN Co's supporting and supplementary submissions.

Based on the information provided by NBN Co, the ACCC is satisfied that the prices charged by NBN Co during 2014-15 did not exceed the maximum regulated prices set by the SAU.

# 1 Introduction

## 1.1 Purpose

On 13 December 2013, the ACCC accepted NBN Co's SAU. The SAU specifies price and non-price terms and conditions relating to access to NBN Co's fibre, fixed wireless, satellite networks and other related services. The SAU will expire on 30 June 2040.

Under Schedule 1F of the SAU, the ACCC is required to make an LTRCM Determination for each financial year of the SAU term within 12 months after the end of that financial year. The first determination must be made by 30 June 2015. Prior to publishing the LTRCM Determination, the ACCC must publish a Draft Determination and its reasons for the Draft Determination and consult with NBN Co and other stakeholders the ACCC considers appropriate.<sup>1</sup>

This report commences the ACCC's public consultation on its assessment of NBN Co's compliance with the SAU provisions in respect of the LTRCM and the price controls. The purpose of this consultation is to obtain stakeholder views on the ACCC's proposed LTRCM Draft Determination. The paper:

- sets out the requirements of the LTRCM process under the SAU
- discusses the regulatory information submitted by NBN Co on 31 October 2014 and the supplementary submission made by NBN Co on 8 December 2014 (together, the LTRCM proposal)
- summarises the ACCC's draft assessment of NBN Co's LTRCM proposal, and
- sets out the ACCC's LTRCM Draft Determination for comment.

This report also includes the ACCC's view on NBN Co's price compliance reporting under the SAU. Under Schedule 1F.3 of the SAU, NBN Co must demonstrate to the ACCC that its prices have not exceeded the maximum regulated prices set by the SAU.

## 1.2 Making submissions

The ACCC encourages industry participants and other stakeholders to consider and make submissions on the issues set out in this Draft Determination, including reasons that support their views.

All submissions will be considered as public submissions and will be posted on the ACCC's website. Interested parties wishing to submit commercial-in-confidence material to the ACCC should submit both a public and a commercial-in-confidence version of their submission. The public version of the submission should clearly identify the commercial-in-confidence material by bookending the confidential material with an appropriate symbol or 'c-i-c'.

The ACCC expects that claims for commercial-in-confidence status of information by parties will be limited in order to promote transparency and broad participation in this consultation process.

The ACCC has published a [Confidentiality Guideline](#) which sets out the process parties should follow when submitting confidential information to communications inquiries commenced by the ACCC. The guideline describes the ACCC's legal obligations with

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<sup>1</sup> See Schedule 1E, Clause 1E.1.2(c)(vi).

respect to confidential information, the process for submitting confidential information and how the ACCC will treat confidential information provided in submissions.

The [ACCC-AER information policy: the collection, use and disclosure of information](#) sets out the general policy of the ACCC and the Australian Energy Regulator (AER) on the collection, use and disclosure of information.

The ACCC prefers to receive submissions in electronic form with searchable text in either PDF or Microsoft Word format. Submitters should ensure that redacted information is not searchable.

Please email submissions by **5 pm Friday 27 March 2015** to:

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### **1.3 Confidentiality**

NBN Co has established confidentiality arrangements for access to confidential material contained in its LTRCM proposal and supporting submissions (discussed in [Section 3.3](#) of this report). The ACCC will monitor the operation of the confidentiality arrangements and considers that the arrangements should achieve an appropriate balance between promoting transparency and protecting NBN Co's confidential information.

The ACCC invites stakeholders to advise the ACCC of any significant concerns about NBN Co's implementation of its confidentiality arrangements.

### **1.4 Next steps in this inquiry**

Following its consideration of submissions on this LTRCM Draft Determination, the ACCC intends to release an LTRCM Final Determination by 30 June 2015. The Final LTRCM Determination will be published on the ACCC website at [www.accc.gov.au](http://www.accc.gov.au).

## 2 The Long Term Revenue Constraint Methodology

### 2.1 What is the LTRCM?

The LTRCM is a methodology for determining the amount of revenue NBN Co is allowed to earn via its prices over the SAU term. This will be done on an ex post basis during the first ten years of the SAU (the Initial Regulatory Period) and on an ex ante basis for the remainder of the SAU period (the Subsequent Regulatory Period), as explained in [Section 2.2](#) below.

In making an LTRCM Determination for each financial year of the Initial Regulatory Period, the ACCC is required to determine the following values (and the inputs to the values):

- Annual Building Block Revenue Requirement (ABBRR)
- Regulatory Asset Base (RAB)
- Initial Cost Recovery Account (ICRA).

The LTRCM sets out a mechanism for determining NBN Co's RAB and ABBRR based on a range of financial inputs that are required to be periodically submitted by NBN Co (discussed in [Section 2.3](#) below). The ABBRR is in turn used, together with NBN Co's actual revenue (as defined in the SAU), to calculate the extent of unrecovered costs in each year, the cumulative value of which is captured in the ICRA. Once NBN Co reaches breakeven point (i.e. it begins to earn 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).<sup>2</sup>

In accordance its obligations under the SAU, on 31 October 2014 NBN Co submitted its regulatory information for consideration by the ACCC. The submission contains regulatory financial information for 2013-14 and certain historical financial information for prior years. NBN Co also made a supplementary submission (and some associated material) on 8 December 2014, to clarify (and in one case adjust) certain aspects of its 31 October 2014 submission. Together, these documents are referred to as the LTRCM proposal in this report. This is the first of the annual LTRCM proposals that must be submitted by NBN Co during the first ten years of the SAU term.<sup>3</sup> [Section 3](#) summarises the details of NBN Co's LTRCM proposal.

### 2.2 The purpose of the LTRCM

The purpose of the LTRCM is to provide NBN Co with the opportunity to recover its prudent and efficient costs of supply (including an appropriate return on investment) over the term of the SAU. The LTRCM is one of various incentives in the SAU to encourage NBN Co to operate and invest prudently and efficiently.

The incentive mechanisms in the SAU are structured differently in the Initial Regulatory Period and the Subsequent Regulatory Period.

#### *Initial Regulatory Period*

During the Initial Regulatory Period, which includes the NBN roll-out, the incentives to incur only expenditures that are prudent and efficient are created through the SAU pricing and

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<sup>2</sup> Clause 1E.6.1 of the SAU.

<sup>3</sup> The Initial Regulatory Period of the SAU applies from 13 December 2013 to 30 June 2023. In the Subsequent Regulatory Period of the SAU, from 1 July 2023 to 30 June 2040, NBN Co's LTRCM reports will change to reflect the shift to a standard building block approach with ACCC ex ante assessment of expenditure and demand forecasts.

revenue provisions:

- The LTRCM gives NBN Co the opportunity to recover its prudently incurred costs over time (including an appropriate return on capital). The ACCC is required to assess NBN Co's expenditure via the LTRCM process against the prudency criteria set out in the SAU.
- Since NBN Co's revenues are insufficient to cover its costs during the initial period, the shortfalls are capitalised in the ICRA. NBN Co may not be able to fully recover these accumulated losses in future unless the eventual take-up of NBN services allows it to earn sufficient future revenue. This revenue sufficiency risk is greater if NBN Co's expenditures are not efficient or prudent. As such, this creates an incentive for NBN Co to operate and invest efficiently.
- NBN prices cannot increase by more than the Consumer Price Index minus 1.5 per cent each year (subject to the exceptions listed at Schedule 1C of the SAU).<sup>4</sup> This means that NBN Co will only be able to increase its revenue by offering new products or increasing demand, meaning NBN Co has an incentive to innovate and to increase take-up of its services.<sup>5</sup>
- The ACCC (or NBN Co) may initiate a price review to rebalance prices, subject to this being revenue neutral. Rebalancing may allow for more efficient pricing signals.
- The ACCC may undertake a price review of a new product or previously zero-priced products within 24 months of a price being introduced by NBN Co.

The SAU intentionally takes an ex-post (actual cost) approach to determining NBN Co's revenues during the Initial Regulatory Period. This is because NBN Co faces uncertainty about whether it will earn sufficient revenue in the future to recover its accumulated losses, and this provides incentives to control its costs during the initial roll-out period. Further, NBN Co is subject to a number of government directions and parliamentary processes, particularly during the roll-out period.<sup>6</sup> This high level of external scrutiny is likely to limit the potential for NBN Co to incur inefficient expenditure.

### ***Subsequent Regulatory Period***

In the Subsequent Regulatory Period, NBN Co will be subject to the standard building block approach where the ACCC undertakes an ex ante assessment of NBN Co's proposed expenditures and their prudency.

During the Subsequent Regulatory Period, NBN Co will submit 'replacement modules' to the ACCC for approval. These replacement modules can be between three and five years and will include forecasts of NBN Co's costs for the corresponding period.

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<sup>4</sup> Unless there has been a tax change event, price review, or an NBN offer in clause 1C.3 has ceased to be zero-priced, the maximum regulated price for each of the NBN offers in Clause 1C.3 will remain fixed (either from the commencement of the SAU or from the first financial year in which the NBN offer is introduced) at the level specified in Clause 1C.3 until 30 June 2017. For NBN offers listed in clause 1C.4, the default maximum regulated price is the price specified in clause 1C.4 for the first year of the SAU or the first financial year in which the NBN offer is introduced. After that, the default maximum regulated price for NBN offers listed in Clause 1C.4 may increase by the Consumer Price Index minus 1.5 per cent each year.

<sup>5</sup> ACCC, NBN Co Special Access Undertaking, Final Decision, 13 December 2013, p. 11.

<sup>6</sup> ACCC, *ACCC Draft Decision on the Special Access Undertaking lodged by NBN Co on 18 December 2012*, April 2013, pp. 141-142.

### **2.3 Regulatory information to be submitted by NBN Co**

To enable the ACCC to conduct its LTRCM assessments during the Initial Regulatory Period, NBN Co is required to submit certain information to the ACCC by 30 June and 31 October every year for the first ten years of the SAU.

By 30 June of each year during the Initial Regulatory Period, NBN Co is required to provide forecast information for the next financial year (Forecast Financial Information).<sup>7</sup> On 30 June 2014, NBN Co submitted its forecast financial information for 2014-15, comprising:

- Capital expenditure, by asset type
- Operating expenditure
- Disposals, by asset type, and
- The opening and closing value of construction in progress – this is capex that has not yet been placed in service.

The Forecast Financial Information submitted by NBN Co on 30 June 2014 will be used in making the ACCC's second LTRCM Determination for 2014-15. NBN Co was not required to submit forecast financial information for 2013-14 since the SAU was only accepted on 13 December 2013; this information is therefore not available for the ACCC's first LTRCM Determination.

By 31 October every year for the first ten years of the SAU, NBN Co must provide:

- a) the actual financial information for the following matters in respect of that financial year (Actual Financial Information):<sup>8</sup>
  - June Quarter CPI
  - Capital Expenditure, by asset type
  - Revenue
  - Operating Expenditure
  - Disposals, by asset type
  - the interest expense
  - accounting and tax asset lifetimes
  - the risk free rate to be used in the calculation of the nominal rate of return under clause 1E.7.1(b) of the SAU
  - the nominal rate of return to be calculated under clause 1E.7.1(a) of the SAU
- b) information which sets out any material variance between the Forecast Financial Information and the Actual Financial Information, including reasons for the variances.<sup>9</sup> As noted above, this does not apply for the current LTRCM Determination
- c) the following proposed values (the Proposed Financial Information)<sup>10</sup>:
  - the ABBRR, including each of the inputs to the ABBRR

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<sup>7</sup> See Clause 1F.1.2 of the SAU

<sup>8</sup> See Clause 1F.1.3 of the SAU

<sup>9</sup> See Clause 1F.1.3(b) of the SAU.

<sup>10</sup> See clause 1F.1.4 of the SAU.

- opening and closing values of the nominal and real RAB
- opening and closing values of the nominal and real ICRA
- opening and closing values of the Construction in Progress (CIP) account
- the unrecovered cost
- the dividend imputation franking credit ('gamma'), and
- the applicable corporate tax rate.

For the first financial year of the SAU's operation (2013-14), NBN Co is also required to submit certain financial information for previous years that is required to calculate NBN Co's ABBRR, RAB and ICRA values.

The SAU's commencement date of 13 December 2013 does not align with standard accounting periods. For the purposes of its LTRCM proposal, NBN Co has therefore treated the SAU commencement as if it occurred on 1 December 2013.<sup>11</sup>

NBN Co must submit reports certifying that its expenditure, procurement and pricing is in accordance with the requirements set out by the SAU. These reports relate to:

*Expenditure compliance and reporting*

Clause 1F.2 requires NBN Co to submit a statement by 31 October each year which certifies that the capital expenditure and operating expenditure proposed for inclusion in the RAB and ABBRR respectively meet the relevant criteria in the SAU. This statement must be signed by the CFO of NBN Co (or authorised delegate). Where NBN Co's actual capital expenditure or operating expenditure does not meet the SAU criteria, the CFO (or delegate) must propose a substitute amount of capital expenditure or operating expenditure for the ACCC's consideration.

At the same time NBN Co must submit a report signed by the Chief Procurement Officer (CPO) certifying that the Procurement Rules (set out in clause 1D.5.1 of the SAU) satisfied the relevant criteria in the SAU.

*Price compliance and reporting*

Clause 1F.3 of the SAU sets out NBN Co's price compliance and reporting requirements. By 31 October each year, NBN Co must submit a report signed by the CFO (or authorised delegate) that certifies that the price of each NBN offer and other charges did not exceed the maximum regulated price for the relevant year, and met the other requirements of Schedule 1C.

NBN Co must also provide any other information that it considers is reasonably necessary for the ACCC to assess NBN Co's compliance with the Schedule 1C of the SAU.<sup>12</sup>

## **2.4 The ACCC's role in relation to the LTRCM process**

The ACCC is required to make an LTRCM Determination for each financial year of the SAU term.<sup>13</sup> For each financial year in the Initial Regulatory Period, the ACCC will issue a determination in respect of the ABBRR, RAB, ICRA and the values of the inputs to each of

<sup>11</sup> NBN Co, Supplementary Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 8 December 2014, p. 10.

<sup>12</sup> See clause 1F.3(a) of the SAU.

<sup>13</sup> See Schedule 1E.1.2(a) of the SAU.

those values (in accordance with Schedules 1D and 1E of the SAU). In making the LTRCM Determination, the ACCC must have regard to the LTRCM proposal submitted by NBN Co and must also follow the decision making process set out in Schedule 1E of the SAU.

The ACCC's role in this process is to determine whether it is satisfied that the expenditure and other values proposed in NBN Co's LTRCM proposal accords with the requirements under the SAU, including whether NBN Co has incurred its expenditures in accordance with the prudence criteria (discussed below).<sup>14</sup>

During the SAU assessment process, the ACCC gave extensive consideration to the degree of *ex post* assessment of the efficiency and prudence of NBN Co's expenditures that would be appropriate over the term of the SAU. For the first ten years of the SAU (approved by the ACCC on 13 December 2013), NBN Co faces uncertainty about whether it will earn sufficient revenue in the future to recover its accumulated losses, and this provides an incentive to control its costs during the initial roll-out period. Further, as noted in the ACCC's Draft Decision on the SAU, NBN Co is subject to a number of government directions and parliamentary processes, particularly during the roll-out period.<sup>15</sup> This high level of external scrutiny is likely to limit the potential for NBN Co to engage in inefficient expenditure.

In deciding on the approach to adopt in assessing NBN Co's first LTRCM proposal, the ACCC has taken into account these incentives for NBN Co to incur prudent and efficient expenditures during the initial roll-out period. The ACCC has also taken into account the large proportion of NBN Co's expenditures during the period covered by its LTRCM proposal that was incurred in connection with categories of expenditure that are considered, under the SAU provisions, to be prudent (that is, expenditure incurred prior to the approval of the SAU, or in connection with interim arrangements or trial sites, or in connection with the Telstra and Optus arrangements). The ACCC considers that, in these circumstances, it is appropriate for the ACCC to rely largely on its assessment of the information submitted by NBN Co, including the reports by its independent auditor and the additional information provided by NBN Co in response to ACCC requests (see section 3).

The ACCC notes that the SAU allows the ACCC flexibility to undertake more extensive scrutiny of NBN Co's expenditure, should there be reason to do so. If the ACCC were to receive information that suggests NBN Co may not have incurred its expenditures in accordance with the SAU, for example in submissions to this or future LTRCM Draft Determinations, the ACCC can seek further information from NBN Co or conduct more extensive investigations of both NBN Co's expenditure processes and its actual procurement activities.

The ACCC will only include operating expenditure and capital expenditure in the RAB, ABBRR and ICRA (as appropriate) to the extent it is satisfied the relevant expenditure meets the conditions in the SAU.<sup>16</sup> For the first ten years of the SAU, the SAU specifies the following criteria for determining the prudence of capital expenditure and assessing whether NBN Co's proposed operating expenditure should be included in the ABBRR.<sup>17</sup>

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<sup>14</sup> See Schedule 1D of the SAU.

<sup>15</sup> ACCC, *ACCC Draft Decision on the Special Access Undertaking lodged by NBN Co on 18 December 2012*, April 2013, pp.141-142.

<sup>16</sup> All expenditure prior to the acceptance of the SAU and some specific items of operating expenditure and capital expenditure are specified to meet the prudence criteria under the SAU.

<sup>17</sup> See Clauses 1D.3-6 and 1E.8 of the SAU.

### *Capital expenditure*

In making the LTRCM determination, capital expenditure may only be included in the RAB to the extent that the ACCC is satisfied (Schedule 1D) that:

- it meets the Prudent Cost Condition<sup>18</sup>—capital expenditure meets the prudent cost condition if it was incurred in connection with the design, engineering and construction of the relevant assets; *and* it was incurred under a ‘conforming contract’ (that is, generally, in accordance with the Procurement Rules), or in an open and competitive market, or through another ‘value for money’ process. The SAU requires NBN Co to develop Procurement Rules that establish procurement processes that generate an efficient and competitive outcome and reflect good industry practice; *and*
- it meets the Prudent Design Condition<sup>19</sup>—capital expenditure meets the prudent design condition if it is ‘materially consistent’ with the Network Design Rules<sup>20</sup> or a permitted variation, endorsed network change or ACCC approved network change to the Network Design Rules, *or*
- capital expenditure was incurred between the Cost Commencement Date (which is on or around 9 April 2009)<sup>21</sup> and the SAU Commencement Date or was incurred in connection with specific matters listed in clause 1D.3.2(a)(ii) of the SAU—capital expenditure is considered to be prudent, under the SAU, if it relates to: the Telstra or Optus arrangements, interim satellite or transit arrangements, trial sites, or third party funded network changes; or was incurred prior to the approval of the SAU on 13 December 2013.

### *Operating expenditure*

Operating expenditure may only be included in the ABBRR to the extent that the ACCC is satisfied (clause 1E.8) that:

- it was incurred in accordance with NBN Co’s procurement processes (including in accordance with the Procurement Rules), was incurred pursuant to a ‘conforming contract’, was procured in an open and competitive market, or was procured in a manner that is likely to achieve value for money, *or*
- it was incurred between the Cost Commencement Date (April 2009)<sup>22</sup> and the SAU Commencement Date (December 2013)<sup>23</sup> or was incurred in connection with specific matters specified in clause 1E.8.2(a)(ii) of the SAU — operating expenditure is considered to be prudent, under the SAU, if it relates to: the Telstra or Optus arrangements, interim satellite or transit arrangements, trial sites, or third party funded network changes; or was incurred prior to the approval of the SAU on 13 December 2013; or it was required to address an urgent network issue or a force majeure event.

The ACCC’s role is to assess whether NBN Co has incurred its expenditure in accordance with the criteria discussed above, and that the relevant LTRCM components have been

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<sup>18</sup> See Clause 1D.3.2(a)(i)(A).

<sup>19</sup> See Clause 1D.3.2(a)(i)(B).

<sup>20</sup> The document describes the design of NBN Co’s fibre, wireless and satellite networks. Capital expenditure must be in accordance with the Network Design Rules in order to be included in the Regulated Asset Base, in addition to also meeting the ‘Prudent Cost’ condition.

<sup>21</sup> See definition of ‘Cost Commencement Date’ in Attachment C to the SAU.

<sup>22</sup> See Attachment C of the SAU

<sup>23</sup> See Attachment C of the SAU

calculated in accordance with the formulas set out in the SAU, and to determine whether those 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, provided those values are determined in accordance with Schedule 1D and Schedule 1E of the SAU.<sup>24</sup>

The SAU also requires NBN Co to maintain and update a set of Network Design Rules<sup>25</sup> and a set of Procurement Rules.<sup>26</sup> Both sets of rules play a role in the assessment of prudence under the SAU. The Network Design Rules sets out the design of NBN Co's relevant assets as updated from time to time in accordance with the SAU and the Procurement Rules must contain competitive tendering and procurement processes. If NBN Co updates its Network Design Rules or Procurement Rules, it must promptly provide a copy of these documents to the ACCC. NBN Co has provided these documents to the ACCC within the timeframes specified in the SAU.

Capital expenditure must be in accordance with the Network Design Rules in order to be included in the RAB, in addition to also meeting the 'prudent cost' condition (as discussed above). Similarly, operating expenditure may only be included in the ABBRR to the extent that the ACCC is satisfied that it was incurred in accordance with the Procurement Rules or satisfies one of the conditions listed in clause 1E.8 of the SAU.

## **2.5 The process for making an LTRCM determination**

This section outlines the processes set out in the SAU that apply to the ACCC in making an LTRCM Determination and records the actions taken by the ACCC to date.

### *Requirement to notify NBN Co of preliminary views*

Within 40 business days of receiving the regulatory information (discussed in section 3.2), the ACCC must notify NBN Co of its preliminary view of the extent to which the ACCC intends to determine a substitute amount of capital expenditure or operating expenditure in making the LTRCM determination.<sup>27</sup>

On 10 December 2014, 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's website.

### *Consultation and publication of decisions*

The ACCC must publish on its website an LTRCM Determination for each financial year in the Initial Regulatory Period no later than 12 months after the end of the financial year to which that LTRCM Determination relates. The first LTRCM Determination (i.e. for 2013-14) must be made by 30 June 2015.

Prior to publishing an LTRCM Determination, the ACCC must publish a Draft LTRCM Determination and its reasons for the Draft Determination and consult with NBN Co and other persons the ACCC considers appropriate. In making its Final Determination, the ACCC

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<sup>24</sup> See Clause 1E.1.2(c)(iv) of the SAU

<sup>25</sup> The document describes the design of NBN Co's fibre, wireless and satellite networks. Capital expenditure must be in accordance with the Network Design Rules in order to be included in the Regulated Asset Base, in addition to also meeting the 'Prudent Cost' condition.

<sup>26</sup> See clause 1D.5.1 of the SAU. The SAU sets out conditions that must be satisfied to ensure that NBN Co engages in competitive tendering and procurement processes.

<sup>27</sup> See clause 1E.1.2(c)(vii)

must consider any submissions that are received within the time limit specified by the ACCC.

This report sets out the ACCC's Draft LTRCM Determination and its reasons for the Draft Determination and commences public consultation with NBN Co and other stakeholders.

#### *ACCC powers to seek additional information*

At any time, the ACCC may request information from NBN Co that the ACCC considers reasonably necessary for it to:

- determine the ABBRR, RAB, ICRA, including the values of the inputs to each of those values
- assess the matters contained in an expenditure compliance report
- assess compliance of NBN Co's Procurement Rules with the requirements for these rules set out by the SAU
- determine NBN Co's compliance with the price schedule set by the SAU.

NBN Co must comply with any request from the ACCC and respond within the timeframes specified by the ACCC.

In developing its preliminary view on NBN Co's proposed operating and capital expenditures and its LTRCM Draft Determination, the ACCC sought additional information and explanation from NBN Co on a voluntary basis. NBN Co provided the requested information and explanation in a supplementary submission provided on 8 December 2014 (see [Section 3.2](#) below).

## **2.6 Price compliance and reporting**

Under Schedule 1F.3 of the SAU, NBN Co must provide certain information to the ACCC to demonstrate that its prices did not exceed the maximum regulated prices set by the SAU.

By 31 October each year, NBN Co must submit to the ACCC a Price Compliance Report signed by NBN Co's CFO that certifies that the prices charged during the preceding financial year did not exceed the maximum regulated prices set by the SAU.

The ACCC may request, at any time, information from NBN Co that is reasonably necessary for the ACCC to determine NBN Co's compliance with Schedule C1 of the SAU.

In assessing NBN Co's price compliance for 2013-14, the ACCC sought some additional information and explanation from NBN Co. NBN Co provided the requested information and explanation in its supplementary submission provided on 8 December 2014

### 3 NBN Co's 2013-14 regulatory information reports

This section provides an overview of the regulatory information submitted by NBN Co to the ACCC in its LTRCM proposal (provided under Schedule 1F of the SAU). NBN Co submitted its regulatory information on 31 October 2014 and provided a supplementary submission on 8 December 2014. Public versions of the submissions are available at [www.accc.gov.au](http://www.accc.gov.au).

NBN Co has established confidentiality arrangements for access to the confidential information contained in its submissions. These arrangements are discussed at [Section 3.3](#) below.

#### 3.1 NBN Co's regulatory information – Received 31 October 2014

On 31 October 2014, NBN Co submitted the following regulatory information for 2013-14 and certain information for previous financial years as required under the SAU.

##### *Financial Statements*

- 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, and
- Schedule 10 – Statement of LTRCM and RAB items

Table 1 below summarises the key financial information submitted by NBN Co.

**Table 1: Summary of NBN Co financial information (nominal, \$million)<sup>28</sup>**

	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14
Operating expenditure	0.1	82.3	330.9	499.4	778.7	1,215.5
Capex	-	7.6	255.0	490.1	1,034.6	1,596.5
Construction in Progress (closing)	-	33.6	234.7	604.4	1,333.0	2,221.1
Revenue	-	-	-	1.9	16.8	61.0
Interest Income		3.9	32.6	60.2	49.0	35.6
RAB (closing)	-	7.6	261.5	700.9	1,574.9	2,901.1
ABBRR	0.1	82.3	335.6	599.6	1,015.9	1,681.7
ICRA - closing	0.1	82.4	425.3	1,060.0	2,128.1	3,899.5

##### *Compliance reports*

- Expenditure Compliance Report – a report signed by CFO certifying that NBN Co's expenditure complies with the requirements of the SAU (the Expenditure Compliance Report)
- Procurement Rules Compliance Report – a report signed by NBN Co's CPO certifying that NBN Co's Procurement Rules<sup>29</sup> comply with the requirements of the

<sup>28</sup> Table 1 reflects the updated figures submitted by NBN Co on 15 December 2014. The interest income for financial year 2013-14 was obtained from NBN Co's 2014 annual report at <http://www.nbnco.com.au/content/dam/nbnco2/documents/nbnco-annual-report-2014.pdf>

<sup>29</sup> These are the procurement rules required under the SAU (1D.5) which must contain a competitive tendering and procurement process.

SAU (the Procurement Compliance Report)

- Price Compliance Report – a report signed by NBN Co’s CFO certifying that NBN Co’s prices for the supply of its services comply with the requirements of the SAU (the Price Compliance Report).

NBN Co also provided the following supporting documents:

- a supporting submission explaining its regulatory information—publicly available on the ACCC website
- Excel versions of the actual and proposed financial information (the LTRCM spreadsheet)—NBN Co has provided a public and confidential version of the spreadsheet
- copies of each Standard Form Access Agreement (SFAA) Price List that applied under the second Wholesale Broadband Agreement (WBA2) and the Satellite WBA—these documents are publicly available on the ACCC website
- three audit reports from PricewaterhouseCoopers (PwC) to support the compliance reports listed above—these reports are confidential
  - Reasonable assurance audit—NBN Co provided an independent report from PwC which provides a reasonable assurance audit of the financial statements submitted by NBN Co (the PwC reasonable assurance report). The report provides an unqualified opinion and complements the audit of the NBN Co’s Limited General Purpose Financial statement.
  - Limited assurance review—NBN Co developed a number of ‘control objectives’ and ‘procedures’ to ensure it can satisfy its SAU expenditure and price compliance obligations. NBN Co engaged PwC to undertake a limited assurance review of the effectiveness of the control procedures in meeting the stated control objectives (the PwC limited assurance report). PwC’s limited assurance opinion is unqualified in nature and complements NBN Co’s CFO certification.
  - Factual findings of agreed upon procedures—NBN Co’s LTRCM spreadsheet for 2013-14 sets out the step-by-step calculations of the proposed RAB, ABBRR and ICRA values. NBN Co engaged PwC to check that the input values in the spreadsheet were correctly extracted from the relevant financial statements in NBN Co’s statutory accounts and that the LTRCM calculations were undertaken in accordance with the SAU formulas (the PwC factual findings of agreed upon procedures). There were no exceptions identified in the report.

### **3.2 Supplementary submission – Received 8 December 2014**

On 8 December 2014, NBN Co provided a supplementary submission comprising the following documents:

- Supplementary submission—public and confidential version. This document provides further explanation of (and in one case adjusts) certain aspects of the Regulatory Information and supporting material submitted by NBN Co on 31 October 2014 following discussions with the ACCC.

In particular, the supplementary submission sets out details of investigations and testing undertaken by NBN Co's internal audit team to check its compliance with the expenditure requirements in the SAU. The submission also sets out some revisions to NBN Co's original approach to confidentiality contained in its submission of 31 October 2014.

- Revised Schedule 10—Statement of LTRCM and RAB items—public version only
- Revised LTRCM spreadsheet—public and confidential version.

### **3.3 Confidentiality**

As noted earlier, NBN Co has claimed confidentiality over certain financial information contained in its LTRCM proposal and supporting submissions made to the ACCC. NBN Co has established confidentiality arrangements for the disclosure of this confidential information to certain classes of persons.

The ACCC considers that public disclosure of information and submissions to the ACCC will assist the ACCC in making regulatory decisions that are robust and based on good evidence. At the same time, the ACCC appreciates that an appropriate balance needs to be struck between protecting parties' genuinely confidential information and promoting confidence in the ACCC's regulatory processes by providing sufficient transparency in relation to the ACCC's decisions.

ACCC accepts that public release of NBN Co's information marked as confidential has potential to cause commercial harm to NBN Co. The ACCC agrees that there should be confidentiality arrangements in place to balance the objectives of promoting transparency and ensuring stakeholders' are able to make informed submissions with NBN Co's interest in avoiding commercial damage from the inappropriate disclosure of commercially confidential information.

The ACCC notes that NBN Co has specified certain exclusions in defining the classes of persons to whom it will disclose certain confidential information under confidentiality arrangements. NBN Co submits that the reason for this limitation is to prevent the information from being used in a manner adverse to NBN Co's commercial interests or for the information to be used to gain a competitive advantage over NBN Co.<sup>30</sup> The ACCC's preferred approach is that, where it is reasonable to do so, information should be disclosed to appropriate persons nominated by stakeholders subject to those persons executing confidentiality undertakings as proposed by NBN Co.

The ACCC will monitor the operation of NBN Co's confidentiality arrangements and in particular, any concerns that NBN Co's implementation of its confidentiality arrangements is not appropriately balancing appropriate disclosure with protection of its confidential information. The ACCC will discuss with NBN Co any concerns raised by stakeholders about the operation of the confidentiality arrangements.

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<sup>30</sup> NBN Co, *NBN Co submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination*, 31 October 2014, p.17. NBN Co, *NBN Co supplementary submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination*, 8 December 2014, p. 5.

## **4 The ACCC's assessment of NBN Co's regulatory information for 2013-14**

This section sets out the ACCC's assessment of NBN Co's regulatory information submitted on 31 October 2014 and its supplementary submission submitted on 8 December 2014.

Under the SAU, the ACCC must issue an LTRCM Determination which contains the items listed in clause 1E.1.2(a) of the SAU. The ACCC has assessed the regulatory information submitted by NBN Co and its draft decision is that the values proposed in NBN Co's LTRCM proposal have been calculated in accordance with Schedule 1D and 1E of the SAU.

The ACCC has received the relevant price compliance report and pricing information under clause 1F.3 of the SAU. Based on the information received under clause 1F.3, the ACCC is satisfied that NBN Co has not exceeded the maximum regulated prices set by Schedule 1C of the SAU.

### **4.1 Assessment of expenditure compliance and reporting**

#### *What the SAU requires*

NBN Co must submit a statement by 31 October each year during the Initial Regulatory Period on whether capital expenditure and operating expenditure proposed for inclusion in the RAB and ABBRR respectively meet the specified criteria, which includes compliance with the Prudent Design and Prudent Cost condition. On the same day, NBN Co must submit a statement certifying its compliance with the Procurement Rules.<sup>31</sup> This is to be signed by the CFO of NBN Co (or authorised delegate). Where capital expenditure or operating expenditure does not meet the specified criteria, the CFO (or delegate) must propose a substitute amount of capital expenditure or operating expenditure for the ACCC's consideration.

At the same time, NBN Co must submit to the ACCC a report signed by the CPO (or authorised delegate) certifying that, in relation to that financial year, the NBN Co's Procurement Rules satisfied the procurement rule requirements set out in the SAU.<sup>32</sup>

#### *Overview of NBN Co's submission*

NBN Co's CFO provided the Expenditure Compliance Report pursuant to clause 1F.2.1(a) of the SAU and the Procurement Rules Compliance Report pursuant to clause 1F.2.3(a) of the SAU. NBN Co certifies that its expenditure complies with the relevant expenditure conditions and Procurement Rules set by the SAU, subject to the qualifications noted in the compliance reports.

The compliance reports submitted by NBN Co use the following qualifying language:

*Based on my knowledge of.... and on the basis that nothing has come to my attention that causes me to believe anything to the contrary...*

NBN Co has referred to Australian Accounting Standards to justify the inclusion of qualifications in its compliance reports (the Australian Standard on Assurance Engagements ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*). NBN Co submits that the Expenditure Compliance Report, together with the PwC assurance reports, provides an appropriate basis for the ACCC to be satisfied that all

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<sup>31</sup> Clause 1F.2 of the SAU

<sup>32</sup> Clause 1F.2.3 of the SAU

capital and operating expenditures incurred by NBN Co over the relevant period meet the relevant prudency conditions.

In relation to its expenditure compliance, NBN Co also lodged an independent assurance report by PwC. NBN Co developed a number of internal processes and controls relating to expenditure (and price) compliance. PwC assessed the design/effectiveness of these processes and controls. PwC's limited assurance report expresses an unqualified opinion and complements the Expenditure Compliance Report. NBN Co submits that its Expenditure Compliance Report, taken together with the PwC assurance report provides an appropriate basis for the ACCC to be satisfied that all capital expenditure and operating expenditure incurred by NBN Co over the relevant period meets the prudency conditions and should be included in the RAB and ABBRR, respectively.<sup>33</sup>

### ***ACCC draft decision on NBN Co's expenditure compliance***

In assessing NBN Co's expenditure compliance, the ACCC has considered the Expenditure Compliance Report signed by NBN Co's CFO, the PwC limited assurance report and NBN Co's supporting and supplementary submissions.

The ACCC has assessed first, whether NBN Co has procedures and processes in place to ensure its expenditures are in accordance with the Prudency Conditions set out in the SAU and second, whether NBN Co has complied with those procedures and processes in incurring expenditures related to the supply of regulated services.

As noted above, the compliance reports provided by NBN Co on 30 October 2014, including the Expenditure Compliance Report, use qualifying language. The ACCC notes that where a limited assurance report is supplied, the Australian Accounting Standards state that a description of the checks that were undertaken and the inherent limitations of those checks should be provided to allow the person receiving the report to assess how much confidence can be placed in the report.<sup>34</sup> In particular, ASAE 3000 sets out certain information that should accompany limited assurance reports, including:

- Section 69(e)

*Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria.*

- Section 69(k)

*An informative summary of the work performed as the basis for the assurance practitioner's conclusion. In the case of a limited assurance engagement, an appreciation of the nature, timing, and extent of procedures performed is essential to understanding the assurance practitioner's conclusion.*

- Section 69(l)(i)

*The assurance practitioner's conclusion: When appropriate, the conclusion shall inform the intended users of the context in which the assurance practitioner's conclusion is to be read.*

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<sup>33</sup> NBN Co, *NBN Co submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination*, 31 October 2014, p.11.

<sup>34</sup> Auditing and Assurance Standards Board, *Standard on Assurance Engagements ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, June 2014.

One of the inherent limitations of an auditing exercise is the impracticality of checking every number and every action by a company. The ACCC therefore sought information from NBN Co to allow it to understand more fully the nature, timing and extent of the investigations and sampling process undertaken by NBN Co to test that it has met the relevant compliance requirements in the SAU.<sup>35</sup>

On 8 December 2014, in response to a request by the ACCC, NBN Co provided a supplementary submission which included additional information to demonstrate how NBN Co met its expenditure compliance obligations under the SAU. In the submission, NBN Co set out in greater detail the investigations and testing undertaken by NBN Co's internal audit team, including its sampling approach to check the effectiveness of NBN Co's internal controls. NBN Co's supplementary submission states that:

- Its internal audit team utilised 'judgemental sampling' and determined sample size guidance with reference to International Professional Practices Framework' (IPPF) Practice Advisor–2320:3 Audit Sampling.
- A sample of 30 transactions was selected from NBN Co's General Ledger Transaction Report from 13 December 2013 to 30 June 2014.<sup>36</sup> These cover a range of suppliers and contracts across the following expenditure types:
  - Capital expenditure (17 items), comprising network capital expenditure (15 items covering Fibre, Fixed Wireless, Satellite and Transit) and non-network capital expenditure (2 items)
  - Operating expenditure (13 items).
- The contracts to which the expenditure relates account for a significant percentage of total expenditure (excluding amounts specified to be prudent under the SAU) over the period 13 December 2013 to 30 June 2014.
- NBN Co undertook end-to-end walkthroughs for each of the sample items to confirm all aspects of the process underpinning the expenditure compliance. This involved identifying a transaction from the General Ledger and tracing it through the end-to-end process identified by the relevant subject matter experts.
- In relation to each relevant control procedure, applicable supporting documentation was identified, recorded and reviewed for its appropriateness. This involved reviewing documentation such as procurement records, contracts, purchase orders, and network design documents for applicability and appropriate authorisation.

The ACCC considers that the information submitted by NBN Co on its internal expenditure processes and controls, and on the checks undertaken by NBN Co to demonstrate that it has implemented these processes and controls, is sufficient to allow the ACCC to assess whether NBN Co's expenditure complies with the SAU requirements. The ACCC also considers that the inherent limitations of NBN Co's compliance checks, which are necessarily based on a sample of transactions, do not raise any significant concerns about NBN Co's compliance with the SAU requirements. The ACCC has also considered the PwC report submitted by NBN Co, which provides a further, independent check of NBN Co's internal processes and controls.

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<sup>35</sup> The supporting submission made by NBN Co on 31 October 2014 noted that the Expenditure Compliance Report is informed by a range of investigations and testing of the relevant processes and controls.

<sup>36</sup> The SAU specifies NBN Co's capital expenditure and operating expenditure prior to 13 December 2013 is considered to be prudent.

Taking into account all of this information, the ACCC's draft decision is that it is satisfied that NBN Co's expenditures comply with the SAU requirements, specifically the prudence requirements set out in Schedule 1D of the SAU.

#### ***ACCC draft decision on NBN Co's compliance with the SAU procurement requirements***

The SAU requires NBN Co to develop Procurement Rules that, in broad terms, establish procurement processes that generate an efficient and competitive outcome and reflect good industry practice.<sup>37</sup> As required by clause 1D.5.2 of the SAU, NBN Co provided a copy of its Procurement Rules to the ACCC within the timeframes set out in the SAU.

The SAU also requires NBN Co to submit a compliance report to the ACCC to certify whether NBN Co's Procurement Rules satisfied the requirements in clause 1D.5.1. The ACCC is satisfied that NBN Co's Procurement Rules Compliance Report comply with the SAU requirements, as required by clause 1F.2.3 of the SAU.

## **4.2 Assessment of proposed financial information**

### ***SAU requirements***

By 31 October after the end of each financial year of the Initial Regulatory Period, NBN Co is required to submit to the ACCC its 'Actual Financial Information' and 'Proposed Financial Information', as set out in Schedule 1F of the SAU.

Actual financial information includes the following:

- June quarter CPI
- capital expenditure, by asset type
- revenue
- operating expenditure
- disposals, by asset type
- interest expense
- accounting and tax asset lifetimes
- risk free rate, and
- nominal rate of return.

Proposed Financial Information includes the following:

- ABBRR, including each of the inputs to the ABBRR
- opening and closing values of the RAB (nominal and real)
- opening and closing values of the ICRA (nominal and real)
- opening and closing values of the CIP account
- unrecovered cost
- proposed impact of dividend imputation franking credits "gamma" (if the net tax allowance is positive), and
- applicable corporate tax rate.

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<sup>37</sup> Clause 1D.5.1 of the SAU

### ***Overview of NBN Co's submission***

On 31 October 2014, NBN Co provided to the ACCC its Actual Financial Information and Proposed Financial Information for 2013-14, along with historical financial information for prior years (as required by the SAU for the first financial year). This information was accompanied by an LTRCM spreadsheet, which provided step-by-step calculations of NBN Co's proposed RAB, ABBRR and ICRA values.

In support of the Actual Financial Information and Proposed Financial Information, NBN Co lodged the following independent assurance reports from PwC:

- reasonable assurance audit in regard to the financial statements submitted by NBN Co (Schedules 6 to 9)—PwC's opinion in this regard is unqualified in nature and complements the existing auditing around the NBN Co Limited General Purpose Financial Statement
- Factual Findings of Agreed Upon Procedures engagement in regard to Schedule 10—PwC checked that the relevant input values are extracted from Schedules 6 to 9 into the LTRCM Spreadsheet and that the relevant LTRCM calculations are undertaken in accordance with the SAU in order to arrive at the output values in Schedule 10. There is no exception identified in the report.

### ***ACCC draft decision on the proposed financial information***

The ACCC has checked the calculations in the LTRCM spreadsheet and confirmed that the formulas used in the spreadsheet are as set out in Schedule 1E of the SAU.

The ACCC identified a minor error in the calculation of the risk-free rate. NBN Co accepted the ACCC's method and amended the calculation of the risk-free rate in its supplementary submission of 8 December 2014.<sup>38</sup>

### ***Treatment of interest income***

NBN Co has been funded by successive equity injections from the Government to roll out its network (totalling \$8.4 billion for the 2014 financial year).<sup>39</sup> Due to delays in the roll-out, NBN Co has placed the unspent equity injections in interest-generating assets. NBN Co has excluded interest income earned on the unspent equity injections in calculating its regulated revenue. The interest income received to date totals \$181.3 million.

The ACCC proposes to accept NBN Co's exclusion of the interest income from its regulated revenue for the following reasons.

This approach ensures equivalent treatment of the interest income and the cost of capital related to the unspent equity injections.

An accepted regulatory principle in applying a 'building block' approach (the approach used in the SAU to calculate NBN Co's allowed revenues) is that the return on the regulated firm's investment should equal the cost of its capital. This allows the regulated firm to recover its efficient costs but does not allow it to earn monopoly profits.

The ACCC considers it appropriate to recognise capital expenditure in the RAB only when it is spent on assets for providing the services. This approach has been adopted by the ACCC and the AER in regulating other infrastructure service providers. It is also adopted under the SAU.

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<sup>38</sup> NBN Co, *NBN Co Supplementary submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination*, Public Version, 8 December 2014, pp. 11-12.

<sup>39</sup> NBN Co, *Corporate Plan 2014-17*, p.50.

This approach treats the interest income earned on equity injections before they are spent on assets as unregulated revenue. No regulatory rate of return (the cost of capital) is allowed on the equity injections until the funds are used to finance capital expenditure. Both the interest income and the cost of capital are excluded in calculating actual regulated revenue and the revenue that is required to recover the business' efficient and prudent costs, respectively.

### **4.3 Assessment of price compliance**

#### ***SAU requirements***

Clause 1F.3 of the SAU requires that by 31 October after the end of each financial year of the Initial Regulatory Period, NBN Co must submit a report signed by the CFO of NBN Co (or an authorised delegate) certifying that, in respect of that financial year the prices for the supply of its services did not exceed the maximum regulated price set by Schedule 1C of the SAU.

NBN Co must also provide any other information that it considers is reasonably necessary for the ACCC to assess NBN Co's compliance with Schedule 1C of the SAU (NBN Offers and other charges).

#### ***Overview of NBN Co's submission***

NBN Co's CFO provided a certification regarding prices pursuant to clause 1F.3(a) of the SAU (the Price Compliance Report). There is no reported exception in this report, which relates to whether, over the period from 13 December 2013 to 30 June 2014, NBN Co's pricing of NBN Offers and Other Charges satisfied the relevant requirements in Schedule 1C.

NBN Co also lodged an independent assurance report by PwC on NBN Co's internal controls in relation to price compliance. PwC's limited assurance opinion is unqualified in nature and complements the NBN Co CFO's certification.

#### ***ACCC view on NBN Co's price compliance report***

The ACCC identified a number of charges where the basis of the charges was not clear, as they were not specified in the initial price list included in the SAU, and requested clarification from NBN Co. The ACCC also advised NBN Co of some minor errors in the prices as listed in NBN Co's submission. In the supplementary submission provided to the ACCC on 8 December 2014, NBN Co corrected these errors and provided the clarification requested by the ACCC.

The ACCC is satisfied that NBN Co's prices for 2013–14 and each preceding financial year from the Cost Commencement Date did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with Schedule 1C of the SAU.

The ACCC considers that PwC's limited assurance review of NBN Co's price controls provides independent assurance that NBN Co has procedures to ensure that its prices do not exceed the maximum regulated prices in the SAU.

## **5 The ACCC's LTRCM Draft Determination**

For the 2013-14 financial year, the ACCC is required to consult on an LTRCM Draft Determination in respect of the ABBRR, RAB, ICRA and the values of the inputs to each of those values.<sup>40</sup> For the ACCC's LTRCM Draft Determination, the ACCC has determined the values in Table 2 below:

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<sup>40</sup> Clause 1E.1.2(a) of the SAU

**Table 2: LTRCM Draft Determination<sup>41</sup>**

<b>Year</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>
June Quarter CPI (annual percentage change) - as per Attachment C to the SAU	-	1.4%	3.1%	3.5%	1.2%	2.4%	3.0%
Cumulative Inflation Factor - as per Clauses 1E.9.4(b) and (c)	-	0.891	0.904	0.932	0.965	0.977	1.000
<b>Rate of Return – as per Clause 1E.7.1</b>							
Risk free rate of interest - as per Clause 1E.7.1(b) and (c)	-	6.699%	5.675%	5.404%	5.224%	3.009%	3.578%
Nominal rate of return - as per Clause 1E.7.1(a)	-	10.199%	9.175%	8.904%	8.724%	6.509%	7.078%

<b>Year</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>
<b>Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1</b>							
Real RAB (start period) - as per Clause 1D.2.1(a) and (b)	-	-	-	8,411	280,613	726,286	1,612,525
Real Capital Expenditure	-	-	8,411	273,580	507,876	1,059,300	1,596,522
Real Disposals	-	-	-	-	-	-	-
Real Straight Line Depreciation	-	-	-	1,378	62,204	173,061	307,909
Real RAB (end period) - as per Clause 1D.2.1(b)	-	-	8,411	280,613	726,286	1,612,525	2,901,139

<sup>41</sup> The clause references in this table refer to the formulas in the SAU.

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<b>Regulatory Asset Base (\$'000 NOMINAL) – as per Clause 1D.2.2</b>							
Nominal RAB (start period) - as per Clauses 1D.2.1(a) and 1D.2.2	-	-	-	7,601	261,506	700,852	1,574,878
Nominal Straight Line Depreciation (as per Clause 1E.9.1(b))	-	-	-	1,284	60,026	169,021	307,909
Nominal RAB (end period) - as per Clause 1D.2.2	-	-	7,601	261,506	700,852	1,574,878	2,901,139

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<b>ABBRR (\$'000 NOMINAL) - as per Clause 1E.4.1</b>							
Return on capital	-	-	-	677	22,814	45,621	111,467
Nominal Regulatory Depreciation –as per clause 1E.9.1(c)	-	-	-	1,014	56,862	152,267	260,417
Nominal Opex	-	139	82,255	330,865	499,419	778,673	1,215,514
Net Tax Allowance	-	-	-	-	-	-	-
Annual Construction in Progress Allowance – as per Clause 1E.10	-	-	-	2,996	20,473	39,340	94,345
ABBRR	-	139	82,255	335,551	599,568	1,015,902	1,681,744

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<b>Taxation Calculations (\$'000 NOMINAL) - as per Clause 1E.9.3</b>							
Nominal Revenue	-	-	-	-	1,944	16,824	60,958
+Value of Assets Received for Nil Consideration	-	-	-	-	-	122,854	67,251
-Nominal Operating Expenditure	-	139	82,255	330,865	499,419	778,673	1,215,514
-Nominal Tax Depreciation	-	-	-	1,245	57,929	164,904	300,744
-Interest Expense	-	-	0	0	15	123	1
Taxable Profit – as per Clause 1E.9.3	-	(139)	(82,256)	(332,110)	(555,420)	(804,023)	(1,388,050)
Tax Loss Carried Forward (Start period) – as per Clause 1E.9.3	-	-	(139)	(82,395)	(414,505)	(969,924)	(1,773,947)
Tax Loss Carried Forward (End period) – as per Clause 1E.9.3	-	(139)	(82,395)	(414,505)	(969,924)	(1,773,947)	(3,161,997)
Net Tax Allowance – as per Clause 1E.9.3	-	-	-	-	-	-	-

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
<b>ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5</b>							
ICRA (start period) – as per Clause 1E.5.2	-	-	139	82,407	425,296	1,060,024	2,128,102
Unrecovered Cost -as per Clause 1E.5.1	-	139	82,255	335,551	597,625	999,078	1,620,786
ICRA (end period) – as per Clause 1E.5.2	-	139	82,407	425,296	1,060,024	2,128,102	3,899,511
Carry Forward Revenue Adjustment – as per Clause 1E.5.3	-	n/a	n/a	n/a	n/a	n/a	n/a