



## ACCC preliminary view on LTRCM capital expenditure and operating expenditure for 2018-19 and issues for further consideration

On 31 October 2019, NBN Co submitted its regulatory information for the 2018-19 financial year as part of the annual long term revenue constraint methodology (LTRCM) process.

The LTRCM process occurs under the NBN Co special access undertaking (the SAU), which is one of the key components of the regulatory framework governing the supply of NBN Co's wholesale services. The objective of the LTRCM is to provide the opportunity for NBN Co to recover its prudently and efficiently incurred costs, including an appropriate return on its investments, over the term of the SAU.

Under the LTRCM, the ACCC must make a determination for each financial year of Module 1 of the SAU (until 2023) that specifies key matters such as NBN Co's annual allowable revenues, unrecovered costs, the initial cost recovery account (which allows recovery of initial losses later in the SAU period) and compliance with expenditure and price control requirements specified in the SAU. As part of this process each year, the ACCC must issue a preliminary view on compliance with SAU expenditure requirements and a draft LTRCM determination.

This will be the sixth time NBN Co and the ACCC have undertaken the LTRCM process. This year's process comes at an important time in the evolution of the NBN. The NBN rollout is nearing completion, with NBN Co expecting to complete the rollout in 2020. NBN Co's expenditure and procurement program has until now been focussed heavily on the rollout and related build activities. As the rollout is completed and the final migration of customers from legacy networks takes place, the focus will move more exclusively to service delivery and NBN Co will enter a business-as usual phase. Further, NBN Co has been increasingly expanding into the contestable enterprise market, which has long been a market characterised by competing networks in CBD localities. This expansion is likely to continue over the coming years.

We consider it important that the LTRCM and other related processes should evolve to ensure ACCC oversight of NBN Co's expenditure and revenues, together with appropriate transparency and compliance measures, remain fit for purpose in light of NBN Co's changing operating environment.

This note sets out the ACCC's preliminary view on NBN Co's compliance with its expenditure rules, as required under the SAU, and highlights a number of issues the ACCC will consider further in the current and future LTRCM processes given the evolving NBN environment.

### **Preliminary view on expenditure compliance for 2018-19**

Under clause 1E.1.2(c)(vii), the ACCC must provide NBN Co with a preliminary view on the extent to which the ACCC proposes to determine substitute amounts of capital expenditure or operating expenditure (as opposed to the values provided by NBN Co in its regulatory information) for the period in question.

The ACCC has reviewed and considered the information provided by NBN Co in its regulatory information and has reached a preliminary view. The ACCC's preliminary view is that it does not intend to determine a substitute amount of capital expenditure in accordance with clause 1D.3.2(d) of the SAU or a substitute amount of operating expenditure in accordance with clause 1E.8.2(c) of the SAU.

The ACCC will now prepare a draft LTRCM determination for consultation with stakeholders in early 2020, before making a final determination by 30 June 2020.

### **Issues for further consideration**

The ACCC will begin giving consideration to the following issues as part of the 2018-19 LTRCM process. These issues represent longer term issues the ACCC will have regard to over the coming years as NBN Co transitions to a different phase of operations.

#### *ACCC oversight of NBN Co expenditure post-rollout*

NBN Co's expenditure and procurement program has to date been focussed on the rollout. This has occurred in accordance with government requirements, as set out in the Statement of Expectations. The majority of this expenditure has been procured through competitive tendering processes or under agreements with Telstra for the migration of customers and for use of its infrastructure.

Although NBN Co will continue to use Telstra infrastructure, NBN Co's expenditure profile is likely to change significantly after the rollout and final migration of customers has been completed. At this stage, NBN Co's operating expenditure should revert to a business as usual state, while its capital expenditure is likely to become comprised of individual projects and programs. In this regard, NBN Co's expenditure profiles will more closely resemble established network operators in other sectors, such as energy.

As the rollout nears completion, the ACCC will consider the need for any additional measures or revised approaches to assessing expenditure given NBN Co's transition to an established network operator. We also note that the present annual ex-post LTRCM process will end in June 2023 (at the end of SAU Module 1). After this time, the assessment of NBN Co's expenditure will take place on a forecast basis every 3 to 5 years (SAU Module 2). We will be mindful of this forthcoming change in considering any approach to expenditure following the rollout.

#### *Transparency costs and revenue of individual services*

The ACCC considers that NBN Co's continued expansion into the enterprise services market may result in concerns about cross-subsidisation between products. This could in turn create a need for further transparency on costs and revenues of individual services in future.

Cross-subsidisation between individual products can be a concern where a regulated entity also provides services in contestable markets. This concern arises if there is the potential for the entity to cross-subsidise services provided in the competitive market from its regulated activities. Such cross subsidies can create advantages to the entity in the competitive market as a result of its regulated activities. These concerns can be alleviated through reporting and transparency requirements for costs and revenues pertaining to individual services. The ACCC has previously operated such arrangements in relation to regulated services provided by Telstra and Australia Post, both of which also operate in competitive markets.

NBN Co's entry into the enterprise services market and concerns about cross subsidisation have been raised in submissions to recent LTRCM processes. For example, Telstra indicated that there is a lack of transparency around NBN Co's costs and revenues and that cross subsidisation towards contestable areas such as enterprise services is a concern. It

also highlighted the potential for a more detailed regulatory accounting framework to alleviate these concerns.

Since the end of the 2017-18 LTRCM process, the ACCC completed an investigation into NBN Co's conduct in supplying wholesale enterprise services and related activities. In October 2019, the ACCC issued a formal warning to NBN Co relating to a failure to comply with its non-discrimination obligations. The ACCC accepted an enforceable undertaking, which included a commitment by NBN Co to take measures to ensure such conduct is not repeated. As NBN Co's activities in the enterprise market expand, we will continue to examine any potential for this to distort competition, particularly in areas already well served by multiple network operators.

We consider that the regulatory information provided by NBN Co as part of the LTRCM process has been sufficient for the purposes of assessing NBN Co's expenditure at an aggregate level. However, we note the regulatory information does not separately identify costs and revenues for individual services. In our consideration of NBN Co's activities in the enterprise market more generally, we propose to give further consideration to the need for additional reporting and transparency arrangements.

#### *Price control compliance*

In recent LTRCM processes, submissions raised concerns about NBN Co's use of discounts to implement new product and pricing initiatives.

On 14 October 2019, the ACCC commenced a public inquiry into the prices that NBN Co charges access seekers to use the NBN for supplying residential grade broadband services. We have sought stakeholder views on NBN Co's use of discounts as part of the inquiry and will consider this issue in that context.

However, we also note that the ACCC has a role under the LTRCM process in assessing compliance with maximum regulated price and price controls set out in the SAU. We would welcome any stakeholder views on the ACCC's specific role in assessing price compliance as part of the LTRCM, keeping in mind we are considering broader pricing issues in the inquiry.

#### **Next steps**

The ACCC is required to follow a structured process set out in the SAU prior to publishing a final LTRCM determination before 30 June 2020. The next stage of our process involves the release of a draft LTRCM determination in the first quarter of 2020 which we will consult on publicly.

Although we will consult following the draft LTRCM determination, we will also consider any feedback on this statement. The ACCC will consider any submissions or feedback we receive prior to 28 February 2020 as part of the draft LTRCM determination.

We expect NBN Co will provide adequate transparency during the 2018-19 LTRCM process, including providing access to interested parties under appropriate confidentiality arrangements.