



Australian
Competition &
Consumer
Commission

NBN Co Special Access Undertaking

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

and

Price Compliance Reporting 2013-14

June 2015



Australian Competition and Consumer Commission
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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
CPI	Consumer Price Index
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
NBN	National Broadband Network
RAB	Regulatory Asset Base
SAU	Special Access Undertaking

Executive Summary

This report sets out the Australian Competition and Consumer Commission's (ACCC) final determination in relation to NBN Co's Long Term Revenue Constraint Methodology (LTRCM) and its view on NBN Co's price compliance for the 2013-14 financial year.

NBN Co's Special Access Undertaking (SAU) forms a part of the regulatory framework for the National Broadband Network (NBN). The SAU was accepted by the ACCC on 13 December 2013. 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 Schedule 1C of the SAU.

Pursuant to clause 1E.1.2(b) of the SAU, the ACCC must issue an LTRCM determination for the 2013-14 financial year no later than 30 June 2015. This is the first time that the ACCC and NBN Co have undertaken this process. This LTRCM determination covers the period from April 2009 (the commencement of the NBN roll-out) until 30 June 2014.

The LTRCM is a methodology for determining the amount of revenue NBN Co is allowed to earn via its prices over the term of the SAU. 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). The LTRCM is one of various incentives in the SAU to encourage NBN Co to operate and invest prudently and efficiently.

The ACCC's final LTRCM determination is to accept without modification NBN Co's proposed values (and the inputs to these values) for the Annual Building Block Revenue Requirement (ABBRR), Regulatory Asset Base (RAB) and Initial Cost Recovery Account (ICRA) in accordance with clause 1E.1.2 of NBN Co's SAU.

With regards to price compliance, the ACCC confirms that it is satisfied that NBN Co's prices for 2013-14 and each preceding financial year from the Cost Commencement Date (9 April 2009) did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with Schedule 1C of the SAU.

The ACCC final determination on NBN Co's LTRCM and price compliance follows the ACCC's draft determination published on 19 February 2015. In making this determination, the ACCC had consideration to submissions made to draft determination by Optus Pty Limited and NBN Co Pty.

1 Introduction

On 13 December 2013, the Australian Competition and Consumer Commission (ACCC) accepted a Special Access Undertaking (SAU) from NBN Co. The SAU establishes a key part of the regulatory framework for the National Broadband Network (NBN). The SAU will expire on 30 June 2040.

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). NBN Co is additionally required under Schedule 1F.3 to certify that its prices have not exceeded the maximum regulated prices set by the SAU. Following NBN Co's submission, the ACCC is required under clause 1E.1.2 of the SAU to make a Long Term Revenue Constraint Methodology (LTRCM) determination within 12 months after the end of each financial year.

The LTRCM is a methodology for determining the amount of revenue NBN Co is allowed to earn via its prices. The purpose of this is to provide NBN Co with the opportunity to recover its prudent and efficient costs of supply (including an appropriate return on investment). The LTRCM is one of various incentives in the SAU to encourage NBN Co to operate and invest prudently and efficiently.

This report sets out the ACCC final determination in relation to NBN Co's LTRCM and its view on NBN Co's price compliance for the 2013-14 financial year. The report is structured as follows:

- Section 2 presents an overview of the LTRCM and assessment processes under the SAU, including the regulatory information submitted by NBN Co on 31 October 2014 and the supplementary submission made on 8 December 2014 (together, NBN Co's LTRCM proposal)
- Section 3 summarises the ACCC's draft determination for the 2013-14 LTRCM and price compliance reporting
- Section 4 summarises the submission made to the draft determination by Optus and NBN Co's cross-submission in reply
- Section 5 presents the ACCC's final assessment of NBN Co's LTRCM proposal and price compliance having had regard to submissions to the draft determination, and
- Section 6 sets out the ACCC's final determination for the 2013-14 LTRCM and price compliance reporting.

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 10 years of the SAU (the Initial Regulatory Period) and on an ex ante basis for the remainder of the SAU period.

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

- Annual Building Block Revenue Requirement (ABBRR)—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.

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 submitted by NBN Co. 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 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).¹

2.2 The ACCC's role in the LTRCM process

During the Initial Regulatory Period of the SAU, the ACCC's role in making an LTRCM determination is to determine whether capital expenditure and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR, respectively. If the ACCC is not satisfied that NBN Co's expenditure meets those requirements the ACCC can determine substitute values in its LTRCM determination.

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 Condition²— 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 Condition³—capital expenditure meets the prudent design condition if it is 'materially consistent' with the Network Design Rules⁴ or a permitted

¹ See clause 1E.6.1 of the SAU

² See clause 1D.3.2(a)(i)(A).

³ See clause 1D.3.2(a)(i)(B).

⁴ 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.

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)⁵ 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 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)⁶ and the SAU Commencement Date (December 2013)⁷ 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 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.⁸

The SAU also outlines the process that the ACCC must follow in making an LTRCM determination. For example, the ACCC needs to formulate and notify NBN Co of its preliminary view within 40 days of receiving NBN Co's LTRCM proposal and the ACCC must consult on and publish its LTRCM draft determination.⁹

2.3 Price compliance and reporting

One of the features of the SAU is to set binding price caps to ensure access seekers are not subject to unreasonable prices and to incentivise NBN Co to incur efficient expenditure. There are a number of pricing provisions in the SAU, the most important being an annual price increase limit of CPI less 1.5 per cent¹⁰.

⁵ See definition of 'Cost Commencement Date' in Attachment C to the SAU.

⁶ See Attachment C of the SAU

⁷ See Attachment C of the SAU

⁸ See clause 1E.1.2(c)(iv) of the SAU

⁹ The requirements for making an LTRCM determination and the powers set out in the SAU that allow the ACCC to request further information from NBN Co are discussed in more detail in chapter 2 of the LTRCM draft determination, 19 February 2015.

¹⁰ See Schedules 1.C.5 and 2.B.2

By 31 October each year, NBN Co must submit to the ACCC a Price Compliance Report signed by NBN Co's Chief Financial Officer (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 1C of the SAU.

2.4 NBN Co's LTRCM proposal

On 31 October 2014 NBN Co submitted to the ACCC an LTRCM proposal as required under Schedule 1F of the SAU. On 8 December 2014 NBN Co lodged a supplementary submission to the ACCC which updated some of the information submitted in its original proposal. As this is the first financial year under the SAU, the LTRCM proposal covers the period from April 2009 (the commencement of the NBN roll-out) until 30 June 2014.

NBN Co's LTRCM proposal consists of the following material.¹¹

- NBN Co's actual financial information – this is based on NBN Co's reported statutory accounts which are consistent with the definitions in the SAU
- NBN Co's proposed financial information – this is NBN Co's proposed values (and inputs to the values) for the ABBRR, RAB, ICRA and certain other inputs to the LTRCM
- an Expenditure Compliance Report – a report signed by the CFO of NBN Co certifying that NBN Co's expenditure complies with the requirements of the SAU
- a Procurement Compliance Report – a report signed by the Chief Procurement Officer (CPO) of NBN Co certifying that NBN Co's Procurement Rules comply with the requirements of the SAU
- Three independent audit reports prepared by PricewaterhouseCoopers (PwC), which were as follows:
 - a reasonable assurance audit of NBN Co's submitted financial statements – this report provides an unqualified complement to NBN Co's internal auditing
 - a limited assurance review of NBN Co's control procedures in place to meet its SAU expenditure and price compliance obligation – this report provides an unqualified complement to NBN Co's CFO certification, and
 - a review of NBN Co's LTRCM calculations to confirm they were consistent with the SAU formulas and NBN Co's statutory accounts.

Financial Information

The financial information submitted by NBN Co includes the following financial statements listed below. A summary of NBN Co's key financial information is presented in Table 2.1. NBN Co also submitted explanatory statements and Excel versions of their actual and proposed financial information.

- Schedule 6 – Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes

¹¹ A public version of NBN Co's LTRCM proposal is available on the ACCC website and is discussed in more detail in chapter 3 of the ACCC's draft determination.

- 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 2.1 Summary of NBN Co financial information (nominal, \$million)¹²

	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

¹² 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>

3 Overview of the ACCC's draft determination

On 19 February 2015, the ACCC released its *NBN Co's Special Access Undertaking Long Term Revenue Constraint Methodology 2013-14: Draft Determination and Price Compliance Report 2013-14*, (draft determination).

The ACCC's draft determination proposed to accept NBN Co's proposed values (and inputs to the values) set out in its LTRCM proposal for the ABBRR, RAB and ICRA. The ACCC's draft determination was based on the ACCC's following assessment, which is presented in more detail below:

- 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.

In making its draft determination, the ACCC considered the regulatory information submitted by NBN Co under Schedule 1F of the SAU. The ACCC released its draft determination for public consultation for a period of five weeks.

Capital expenditure and operating expenditure

As discussed in section 2, in making an LTRCM determination, capital expenditure and operating expenditure may only be included in the RAB and ABBRR respectively to the extent that the ACCC is satisfied that the expenditure meets the relevant requirements in the SAU.

In making its draft determination, the ACCC examined the processes and procedures NBN Co has established to ensure its expenditure was incurred in accordance with the prudency conditions in the SAU and then assessed whether NBN Co had complied with those processes and procedures.

In establishing whether NBN Co had the appropriate processes and procedures in place, the ACCC considered information NBN Co had submitted to the ACCC as part of the 2013-14 LTRCM proposal. In particular, the ACCC considered NBN Co's Expenditure Compliance Report, which included a qualified certification that NBN Co's expenditure complied with the relevant expenditure conditions. The ACCC sought further information from NBN Co to better understand the nature of the qualification.

NBN Co's supplementary submission to the ACCC of 8 December 2014 provided further details about the sampling process undertaken as part of NBN Co's audit. The supplementary submission provided information about the transactions selected from NBN Co's General Ledger for sampling and the measures NBN Co had taken in tracing the transaction through the end-to-end process, thus demonstrating its processes underpinning expenditure compliance. NBN Co's supplementary submission also included further information about reviews conducted by NBN Co on procurement records, contracts, purchase orders and network design documents.

The ACCC considered that this supplementary submission along with other information submitted by NBN Co demonstrated that it has processes in place to ensure its expenditure was incurred in accordance with the prudency conditions set out in the SAU.

Furthermore this information along with the PwC limited assurance report provided a further independent check of NBN Co's internal process and controls. As such the ACCC was satisfied that NBN Co's expenditure complied with the SAU requirements, specifically the prudence requirements set out in Schedule 1D of the SAU.

The ACCC was also satisfied that NBN Co's Procurement Rules Compliance Report complied with the requirements set out in clause 1F.2.3 of the SAU.

Financial information

The other aspect to the ACCC's draft determination was whether NBN Co's proposed LTRCM values had been calculated in accordance with Schedule 1D and Schedule 1E of the SAU.

NBN Co's LTRCM proposal included the lodgement of 'Actual Financial Information' and 'Proposed Financial Information' in addition to historical financial information that was incurred prior to the commencement of the SAU. This information was accompanied by a spreadsheet that set out step-by-step calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA. NBN Co also supplied an independent reasonable assurance report from PwC supporting the Actual and Proposed Financial Information.

In making its draft determination, the ACCC checked the calculations NBN Co submitted in its LTRCM spreadsheet and confirmed that the formulas used in the spreadsheet are as set out in Schedule 1E of the SAU.

As noted in the draft determination the ACCC found a minor error in NBN Co's calculation of the risk-free rate and NBN Co amended this calculating error in its supplementary submission of 8 December 2014.

The ACCC's preliminary view as set out in the draft determination, was to accept NBN Co's proposal to exclude interest income from its regulated revenue.¹³

Price compliance

The ACCC's preliminary view on price compliance was that the ACCC was satisfied that NBN Co has not exceeded the maximum regulated prices set by Schedule 1C of the SAU. The ACCC made its draft determination after consideration of a report signed by NBN Co's CFO and an independent assurance report by PwC on NBN Co's internal controls in relation to price compliance.

As noted in the draft determination, the ACCC found some minor errors in the prices as listed in NBN Co's original submission. In NBN Co's supplementary submission, these errors were corrected. The ACCC formed the preliminary view that NBN Co's prices for 2013–14 and each preceding financial year from the commencement of the SAU did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with Schedule 1C of the SAU.

¹³ See discussion on page 25 of the draft determination.

4 Submission to the ACCC's draft determination

The ACCC received one submission from Optus in response to the draft determination and a cross-submission from NBN Co. Both submissions only discussed the LTRCM aspect of the draft determination.

Optus' submission comments that this first LTRCM process represents an important opportunity for the ACCC and industry to ensure that the SAU is working as intended and promoting the long-term interest of end-users. It raised three main issues regarding NBN Co's LTRCM proposal related to the Network Design Rules, the Procurement Rules and the use of qualifying language in NBN Co's compliance reports.

NBN Co's submission responds to the three main issues raised in the Optus submission.

The Optus and NBN Co submissions are summarised below.

4.1 Optus submission

NBN Co's Network Design Rules are outdated

Optus submitted that the SAU and NBN Co's Network Design Rules do not reflect the Government's policy changes to the NBN design and suggest that the ACCC's ability to assess NBN Co's capital expenditure is limited by the outdated Network Design Rules.

Optus' submission notes that NBN Co is required under the SAU to update its Network Design Rules to reflect any changes to the Government's Statement of Expectations.¹⁴ Optus also points out that NBN Co's current Network Design Rules were last updated on 1 July 2014 and as such do not reflect the Government's recent Statement of Expectations from April 2014 which directs NBN Co to transition the NBN from a primarily fibre-to-the-premise model to the multi-technology mix model.

Optus argues that the ACCC's assessment of NBN Co's capital expenditure against the Network Design Rules is limited and any expenditure incurred by NBN Co in relation to the multi-technology mix model could not be deemed prudent by the ACCC or added to NBN Co's RAB.¹⁵

More generally, Optus submits that the SAU is out of date as it continues to refer to fibre-to-the-premise policy. It argues that the SAU needs to be varied to reflect the Government's Statement of Expectations which will enable the Network Design Rules to be updated.¹⁶

A lack of transparency regarding NBN Co's Procurement Rules

Optus notes that NBN Co's Procurement Rules are a key factor in assessing NBN Co's capital and operating expenditures and whether this expenditure should be included in the RAB and ABBRR, respectively. Optus commented that because the Procurement Rules are not publically available, Optus is unable to comment on either the prudence of NBN Co's capital expenditure or suitability of NBN Co's operating expenditure.¹⁷

¹⁴ The Government Statement of Expectations is provided to NBN Co, which is a Government Business Entity, by its shareholder ministers – the Minister of Communications and the Minister of Finance – to clearly articulate the Government's expectations whilst respecting NBN Co's independence.

¹⁵ Optus Submission in response to the ACCC Draft Determination Long Term Revenue Constraint Methodology 2013-14 Public Version March 2015, pp.3-4.

¹⁶ Ibid. p.2

¹⁷ Ibid. pp 5-6

Optus's submission also raised concerns over the lack of transparency of confidential information contained in NBN Co's LTRCM proposal and its supporting submissions. Specifically, Optus noted that it has not had an opportunity to review NBN Co's confidential material prior to making its submission and therefore could not provide comments on certain aspects of the draft determination.¹⁸

The use of qualifying language in NBN Co's compliance reports

Optus' submission raised concerns that the certifications provided by NBN Co in relation to expenditure obligations and compliance with the Procurement Rules are qualified. The certifications attest that NBN Co has complied with the prudency conditions, the maximum regulated prices and the Procurement Rules set by the SAU but are qualified. Optus suggests that the qualifications in the compliance certificates do not provide positive certification that the expenditure incurred by NBN Co was prudent.

Optus further notes that network operators are subject to much stricter certifications under the ACCC's Telecommunications Industry Regulatory Accounting Framework (RAF). Optus submits that the ACCC should not accept the certification by NBN Co and that the ACCC should require NBN Co to sign compliance certificates consistent with the reporting obligations imposed under the RAF.¹⁹

4.2 NBN Co's cross submission

NBN Co's Network Design Rules

In response to Optus comments about NBN Co's Network Design Rules, NBN Co notes that under clause 1D.6 of the SAU, the Prudent Design Condition can be satisfied through one of three ways. In order for the ACCC to be satisfied that capital expenditure meets the Prudent Design Condition, expenditure must be:

- "materially consistent" with the Network Design Rules
- a Permitted Variation to the Network Design Rules, or
- an ACCC approved network change to the Network Design Rules.

NBN Co notes that it could rely on the Permitted Variation provisions in the SAU to assess the capital expenditure incurred in relation to the transition to the multi-technology mix. NBN Co notes that it intends to update the Network Design Rules to reflect the multi-technology mix in a future update, once the relevant design aspects are settled.

The SAU allows the Network Design Rules to evolve over time and in response to any change in the Government's Statement of Expectations. As such, NBN Co argues that under the SAU, it can transition to the multi-technology mix without having to first update the SAU.²⁰

A lack of transparency regarding NBN Co's Procurement Rules

NBN Co notes the submissions made by Optus in relation to the lack of transparency in relation to its Procurement Rules, but argues that the confidentiality is appropriate because the Procurement Rules are highly sensitive and their disclosure could significantly damage NBN Co's ability to procure goods and services in a cost effective manner.

¹⁸ Ibid. p.2

¹⁹ Ibid. pp 7-8

²⁰ NBN Co Special Access Undertaking—Draft LTRCM Determination for 2013-14, comments on Optus submission, April 2015, pp 1-2.

NBN Co submits that the Procurement Rules are referred to as one of the factors the ACCC must consider in assessing capital expenditure under clause 1D.4.2 and operating expenditure under clause 1E.8.4. The submission notes that the ACCC is able to also consider any other factors it considers relevant in addition to the Procurement Rules.²¹

NBN Co noted that it has established confidentiality arrangements that all stakeholders could avail themselves of to access NBN Co's confidential material.²²

The use of qualifying language in NBN Co's compliance reports

NBN Co rejects Optus' submission in relation to the use of qualifying language in the compliance reports. It notes that the process of investigating and testing by which the compliance reports are prepared are, by their nature, subject to internal limitations as some deficiencies may not be detected. In developing the qualifying language, NBN Co had regard to the Australian Standard on Assurance Engagements ASAE 3000 'Assurance Engagements Other than Audits or Reviews of Historical Financial Information'.²³

²¹ Ibid. p.2

²² Ibid. p.1

²³ Ibid. pp 2-3

5 ACCC's assessment

The ACCC has completed its assessment of NBN Co's regulatory information submitted on 31 October 2014 and NBN Co's supplementary submission of 8 December 2014. In making its assessment the ACCC has also taken into consideration submissions received from Optus and NBN Co in response to the ACCC's draft LTRCM determination published on 19 February 2015. The following section provides an overview of the ACCC assessment, including responses to the submissions by Optus and NBN Co.

5.1 LTRCM assessment

Capital expenditure and operating expenditure

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, NBN Co's supporting and supplementary submissions and submissions made by Optus and NBN Co in response to the ACCC's draft determination.

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 and secondly, whether NBN Co has complied with those procedures and processes when incurring expenditure related to the supply of regulated services.

Use of qualifying language in Expenditure Compliance Report

NBN Co provided the ACCC with an Expenditure Compliance Report, which included qualifying language. The ACCC considered it to be appropriate to seek further information from NBN Co regarding the investigations and sampling processes undertaken when preparing the compliance report in order to assess how much weight could be placed on the report given the qualifying language used.

On 8 December 2014, NBN Co provided a supplementary submission which set out in detail the investigations and testing undertaken by NBN Co's internal audit team. Among other things, the supplementary submission explained how the sampling process to check transactions was prepared, the type of transactions included in the sampling process, the end-to-end walkthroughs of each transaction in the sample to check compliance and the review of supporting documentation, such as procurement records, contracts and network design documents. The ACCC considered the supplementary submission, together with the report of PwC which provided a further independent check of NBN Co's processes and procedures.

In making its draft determination, the ACCC noted its preliminary view that it was satisfied that NBN Co's expenditures comply with the SAU requirements, specifically the Prudent Cost and Prudent Design Conditions.

The ACCC has considered the concerns raised by Optus regarding the use of qualifying language in response to its assessment of NBN Co's expenditure compliance. As discussed in the draft determination the use of qualifying language did raise questions regarding the degree to which the ACCC could rely on the Expenditure Compliance Report provided by NBN Co. However, the ACCC considers that the additional information sought from NBN Co confirms that NBN Co undertook an appropriate process to check whether the compliance processes and procedures in place were adequate. The ACCC considers that the sampling exercise undertaken was sufficient to allow the ACCC to determine whether NBN Co's expenditure complies with the SAU requirements.

Network Design Rules

The ACCC has also considered concerns raised by Optus regarding the failure of the Network Design Rules to be updated to reflect the Government's Statement of Expectations regarding the transition to a multi-technology mix model. The ACCC has also had regard to the matters raised by NBN Co in reply.

The ACCC considers that it is appropriate to update the Network Design Rules to reflect the Statement of Expectations given to NBN Co in April 2014. The ACCC notes NBN Co's intention to update the Rules to account for the transition to the multi-technology mix model once the relevant design aspects are settled.

However, the ACCC does not consider that the failure to update the Rules means that an assessment of the capital expenditure cannot be undertaken. Rather, the ACCC accepts NBN Co's submission that the Prudent Design Condition can be satisfied if the capital expenditure was incurred within the scope of the Network Design Rules or a Permitted Variation. As noted above, a Permitted Variation to the design set out in the Network Design Rules includes a variation or change to comply with, relevantly, the Statement of Expectations or any requirement of the Shareholder Ministers. As such, the ACCC has concluded that it can assess NBN Co's expenditure compliance with the prudency conditions of the SAU.

Transparency of NBN Co's Procurement Rules

The ACCC notes that Optus has been unable to comment directly on NBN Co's compliance with the Prudent Cost Condition because it has not been able to view NBN Co's Procurement Rules. In order to demonstrate compliance with the Prudent Cost Condition, Optus notes that NBN Co must be compliant with its Procurement Rules.

Under clause 1D.5.2, NBN Co provided the ACCC with a copy of its Procurement Rules that, in general, establish procurement processes that generate an efficient and competitive outcome and reflect good industry practice. NBN Co also provided the ACCC with a Procurement Rules Compliance Report that certifies that NBN Co has complied with the rules.

The ACCC has considered Optus' submission that the Procurement Rules should be public in order for NBN Co's compliance with the Prudent Cost Condition to be assessed. However, the ACCC considers that it is appropriate for the Procurement Rules to remain confidential. Procurement processes are often commercially sensitive and the ACCC accepts NBN Co's concerns that if the Rules were to be made public, it could damage NBN Co's ability to procure goods and services in a cost effective manner.

The ACCC is satisfied that it can rely on the Procurement Compliance Report to assess NBN Co's compliance with the Prudent Cost Condition.

ACCC's conclusion in relation to expenditure and procurement requirements

The ACCC, having taken into account the information and submissions noted above, is satisfied that NBN Co's expenditures comply with the SAU requirements, specifically the prudency requirements set out in Schedule 1D of the SAU.

Further, the ACCC is satisfied that NBN Co's Procurement Rules Compliance Report satisfies the SAU requirements as required by clause 1F.2.3 of the SAU.

On a related point the ACCC notes that NBN Co has established confidentiality arrangements so that interested parties can gain access to confidential material contained in NBN Co's LTRCM proposal and its supporting submissions. The ACCC will monitor the suitability of NBN Co's confidentiality arrangements to ensure they strike a balance between protecting parties' genuinely confidential information and promoting transparency in regulatory process.

Assessment of Financial information

In assessing whether NBN Co's proposed LTRCM values have been calculated in accordance with Schedule 1D and Schedule 1E of the SAU, the ACCC has considered NBN Co's 'Actual Financial Information' and 'Proposed Financial Information' in addition to historical financial information that was incurred prior to the commencement of the SAU. The ACCC has also had regard to a spreadsheet that NBN Co has prepared that sets out the calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA and a reasonable assurance report from PwC in regards to this financial information.

The ACCC did not receive any submission on its draft determination to accept NBN Co's proposed values for the RAB, ABBRR and ICRA. Nor has the ACCC received any further information from NBN Co, or any other party, on the proposed LTRCM values or the calculations used to determine these values.

The ACCC therefore determines that it accepts NBN Co's LTRCM values for the RAB, ABBRR and ICRA and confirms that they have been calculated in accordance with the formulas set out in Schedule 1E of the SAU.

Price compliance

The ACCC has considered a certification provided by NBN Co regarding prices pursuant to clause 1F.3 (a) of the SAU (the Price Compliance Report). The ACCC has also had regard to an independent assurance report by PwC on NBN Co's internal controls in relation to price compliance.

The ACCC did not receive any submissions in relation to the ACCC's preliminary view regarding price compliance as set out in the draft determination.

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

6 ACCC's 2013-14 LTRCM determination and price compliance assessment

In accordance with clause 1E.1.2 of the SAU, the ACCC has determined the values set out in Table 6.1 below for the ACCC's LTRCM determination for the 2013-14 financial year.

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.

Table 6.1 2013-14 LTRCM determination²⁴

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
CPI and Cumulative Inflation Factor							
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

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Rate of Return – as per clause 1E.7.1							
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%

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Regulatory Asset Base (\$'000 REAL) – as per clause 1D.2.1							
Real RAB (start period) - as per clause 1D.2.1(a) and (b)	-	-	-	8 411	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

²⁴ 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
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	-	-	-	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
ABBRR (\$'000 NOMINAL) - as per clause 1E.4.1							
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
Taxation Calculations (\$'000 NOMINAL) - as per clause 1E.9.3							
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
ICRA and CFRA (\$'000 NOMINAL) – as per clause 1E.5							
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