

## Chapter 2

### Progressive summary of inquiry issues and findings

2.1 On 11 April 2008 the Minister for Broadband, Communications and the Digital Economy, Senator the Hon Stephen Conroy, announced the release of a Request for Proposals (RFP) to 'roll-out and operate a new, open access, high-speed, fibre-based broadband network, providing downlink speeds of at least 12 megabits per second to 98 per cent of Australian homes and businesses.'<sup>1</sup>

2.2 Clause 1.3 within the RFP listed the 18 Commonwealth objectives (see appendix 3), for the National Broadband Network (NBN), while clause 1.4 provided the six evaluation criteria (appendix 3) against which each proposal was to be assessed 'within the framework of an overarching value-for-money assessment'.<sup>2</sup> A Panel of Experts was tasked with providing a report to the minister recommending an outcome by the end of January 2009; it was widely anticipated that the minister would announce that outcome shortly after receiving that report.

#### Key issues and findings

2.3 From the outset, the announcement of government funding of up to \$4.7 billion to build and operate the NBN came under criticism from many sectors within the telecommunications industry. These criticisms were widely based, including the coverage footprint, the technology specified, and the RFP process itself; a summary of the main issues detailed in this committee's December 2008 Interim report follows.

#### *Footprint*

2.4 The RFP document did not provide specific detail of the coverage modelling that would be used to determine the footprint of the proposed 98 per cent of Australian homes and businesses that the NBN would service. States with large, sparsely populated areas sought assurance from the government that the coverage footprint would not be measured on population densities alone. Typical of such concerns were those expressed by the Queensland Government, which stated that:

The Queensland Government does not wish the NBN 98 per cent threshold to be allocated in Queensland purely on a population density basis.<sup>3</sup>

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<sup>1</sup>[http://www.archive.dbcde.gov.au/2009/april/national\\_broadband\\_network\\_request\\_for\\_proposals\\_process](http://www.archive.dbcde.gov.au/2009/april/national_broadband_network_request_for_proposals_process) , accessed 17 April 2009.

<sup>2</sup> Request for Proposals to Roll-out and Operate a National Broadband Network for Australia, p. 6.

<sup>3</sup> *Submission 5*, 'Policy and Funding Initiatives to provide Enhanced Broadband to Rural and Remote Areas', p. 6.

2.5 Its submission to the Department of Broadband, Communications and the Digital Economy (the Department) on suggestions for deployment to remote areas provided comparative maps to demonstrate the vast differences in footprint achievable using different coverage modelling. A map of 98 per cent broadband coverage for Queensland, based on population density alone, clearly concentrated coverage along the densely populated eastern coastline, while ignoring the vast majority of the state's regional, rural and remote population centres. In stark contrast, a subsequent map of the 98 per cent footprint was provided that included population centres in far western and northern Queensland, in addition to all educational, health, emergency and government library facilities throughout the state.

2.6 The South Australian Government voiced identical concerns. An evaluation of the 98 per cent NBN coverage footprint, based on that state's population density alone, revealed that 'only 4 per cent of the state's land mass would have been covered.'<sup>4</sup>

2.7 Representatives of the Western Australian Government identified that although the vast majority of that state's population lived in metropolitan Perth, the 'bulk of the wealth of this nation' was generated by a small percentage of Western Australia's population situated in the mineral resource-intensive, remote north-west, which would be excluded from the NBN if coverage were to be based on population density alone. In fact, concern was expressed that, in the extreme, the whole state was at risk of becoming the two per cent that would not be covered by the NBN footprint.<sup>5</sup>

2.8 Criticism was also levelled at what modelling would be used to evaluate a proponent's stated ability to achieve the 98 per cent coverage. The Department resisted attempts to provide any such modelling parameters, despite the substantial uncertainty generated within the industry by the cancellation of the OPEL contract on the basis of disputed coverage modelling.

2.9 On another level, the government was criticised for insisting that fibre technology be utilised to provide broadband services to 98 per cent of Australian homes and businesses, with the view that this was simply not economically viable for any broadband provider within the \$4.7 billion funding envelope. Mr Paul Budde stated in evidence to the committee that 91-93 per cent may be feasible, but to attempt 98 per cent was 'just silly'<sup>6</sup>.

2.10 Under the government's recently announced proposal for a fibre-to-the-premise (FTTP) NBN, there has been a revision of the 98 per cent fibre footprint, with the government stating the NBN would instead 'connect 90 per cent of Australian homes, schools and workplaces'. However, the government has yet to

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4 See South Australian Government, *Submission to the Regional Telecommunications Independent Review Committee (RTIRC)*, December 2008, p. 7.

5 See Mr Anson Cheng, WA DOIR, *Committee Hansard*, Perth, 6 November 2008, pp 12-14.

6 Mr Paul Budde, Paul Budde Communications, *Committee Hansard*, Sydney, 7 October 2008, p. 84.

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provide any modelling for how they intend to assess that 90 per cent, in particular whether it will be measured on population density alone.

### ***Roll-in or roll-out***

2.11 As the RFP did not specify a deployment schedule, concerns were expressed that the successful proponent could easily utilise the \$4.7 billion funding to merely upgrade existing metropolitan infrastructure without addressing any of the existing black spots or underserved areas, or at best, with those areas having to wait years before seeing any improvement in their broadband services.

2.12 Several submissions recommended that initial implementation commence in the areas that were unserved or underserved, arguing that the NBN should be rolled-in to the cities, rather than rolled-out from the cities. A typical comment received by the committee was that of Mr Gregory Hicks, from the Adelaide-based company, Adam Internet, when he observed that implementing a roll-in of the NBN '...then puts broadband where it is needed most, and that is to the people who do not have it.'<sup>7</sup>

2.13 A roll-in schedule was repeatedly advocated to this committee by a variety of industry stakeholder groups, including ISPs, telcos, potential bidders and consumer advocates.<sup>8</sup> Comments from Ms Teresa Corbin, Consumers Telecommunications Network, clearly summarised these concerns in her evidence when she commented:

I cannot urge strongly enough that some of those remote and regional areas that are not getting internet at the moment are the ones that should be prioritised [for deployment of the NBN]. They should not have to wait five years, because they already do not have access.<sup>9</sup>

2.14 The Australian Bureau of Statistics 2006 census noted that Tasmania had the lowest proportion of households able to access the internet and broadband, at just 55 and 29 per cent respectively<sup>10</sup>. This low level of connectivity was almost on a par with the connectivity levels measured in remote areas by the census. Despite high population densities in a number of centres throughout Tasmania, the lack of competitive backhaul across Bass Strait and the consequential high prices for internet and broadband subscriptions are the major causes of this low level of connectivity.

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7 Mr Gregory Hicks, Chairman Adam Internet, *Committee Hansard*, Sydney, 7 October 2008, p. 42.

8 See for example, AAPT, *Submission 4*, p. 7; Terria, *Submission 12*, p. 8; iiNet, *Submission 3*, Regulatory Submission On the Requirements for an Open Access National Broadband Network', June 2008, p. 6.

9 Ms Teresa Corbin, Consumers Telecommunications Network, *Committee Hansard*, Sydney, 7 October 2008, p. 76.

10 *State of the Regions 2008-09*, p. 58.

2.15 In its submission Digital Tasmania, drew attention to the low connectivity levels across Tasmania, arguing that the government should ensure the NBN corrects this anomaly:

Historically underserved regional and rural areas, including Tasmania [should be] some of the first to receive the benefits of an NBN rollout.<sup>11</sup>

### ***Technology***

2.16 The RFP had specified that the successful proponent should deploy 'fibre-to-the-node or fibre-to-the-premises network architecture'.<sup>12</sup> There was general consensus that this was one area where the RFP was actually over-prescriptive, with many stating that a one-size-fits-all (i.e. fibre-based) approach would not meet the demands of Australia's vast, geographically diverse and sparsely populated land mass.

2.17 While fibre is widely acknowledged as technically superior in current technology terms, by prescribing fibre within the RFP, the government precluded solutions offering mixed technology platforms that may have proved more economically viable, particularly in areas where geographical barriers to terrestrial infrastructure exist. An example of this view was provided by AUSTAR:

Given the vast density and topographical differences between metropolitan and regional Australia, adopting a single, national technology approach is not the most effective solution and is unlikely to be sustainable over the longer term ... [broadband] services should be provided with fit-for-purpose network solutions ...<sup>13</sup>

2.18 Despite industry consensus that fibre provided superior technology, the committee noted there was a progressive acceptance that a FTTP solution would be unachievable within the \$4.7 billion funding package, with the subsequent unspoken assumption that a fibre-to-the-node (FTTN) solution would be selected rather than a FTTP solution.

2.19 However, the committee heard from several witnesses that a FTTN solution would not meet the government's requirement that the technology be 'future-proof'. One such witness told the committee that he believed FTTN would actually be a backward step for Australia:

I am particularly concerned about the prescription of fibre-to-the-node technology for the national broadband network. I believe that if it is to be prescribed as a fibre to the node ... where it makes it difficult for it to go beyond that to fibre to the home, it is a retrograde step.<sup>14</sup>

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11 Digital Tasmania, *Submission 18*, p. 3.

12 Department of Broadband, Communications and the Digital Economy (DBCDE), *Request for Proposals to Roll-out and operate a National Broadband Network for Australia*, 11 April 2008, paragraph 1.3.1.5, p. 5.

13 AUSTAR United Telecommunications, *Submission 16*, p. 9.

14 Dr Ross Kelso, *Committee Hansard*, Brisbane, 21 November 2008, pp 20-21.

2.20 In the Interim Report, this committee stated that the exclusion of wireless or satellite technology in the RFP was a limitation that would prevent the delivery of more affordable high speed broadband services for populations in rural and remote areas, and suggested that the platform should be broadened to include those technologies.<sup>15</sup>

2.21 In his criticism of the requirement for a 'national' solution, Professor Joshua Gans indicated in his submission that solutions needed to be tailored to better meet the local area needs and that consequently a disaggregated approach could be warranted.<sup>16</sup>

2.22 Mr Arthur Price from Axia NetMedia described the technical solution that his company had deployed in the Canadian state of Alberta, where fibre was pushed out as close to the premise as possible in all areas, but that '...wireless links in Alberta are ... typically where you actually could not implement fibre for some geographical reason.'<sup>17</sup> There are parallels that can be readily drawn in Australia where rugged and remote terrain makes the deployment of fibre expensive and/or impractical.

2.23 In chapter 3, the committee notes that the government's 2009 broadband initiative is more inclusive of mixed technology platforms. In addition to requiring a FTTP solution to 90 per cent of Australian homes, schools and workplaces, the government has stated it will 'use next generation wireless and satellite technologies'<sup>18</sup> to improve broadband services for those living in more remote areas of Australia, where the committee has heard that it is not economically viable, and is often geographically impossible, to lay fibre.

### ***Funding concerns***

2.24 The government's 2008 NBN proposal to provide funding of up to \$4.7 billion was generally applauded by the industry, both here and overseas. However, there were strong criticisms regarding the sourcing of the \$4.7 billion.

2.25 Concern was expressed that the government had closed the \$2 billion Communications Fund, which had been set aside by the previous Howard Government as a 'perpetual' fund for the provision of metro-comparable telecommunication services in regional and remote Australia. Assets from this fund, together with around \$2.4 billion from the Telstra 3 sale process, would be rolled into the \$20 billion Building Australia Fund (BAF), from where the \$4.7 billion would be drawn. Even with this considerable government funding, concern was expressed that prospective proponents would find it difficult to raise the still-significant amount of financial backing required by them to build and operate the NBN.

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15 See National Broadband Network, *Interim Report*, paragraph 4.55, p. 78.

16 Professor Joshua Gans, *Submission 15*, p. 1.

17 Mr Arthur Price, Axia NetMedia, *Committee Hansard*, Canberra, 24 November 2008, p. 13.

18 Joint Media Release, [www.minister.dbcde.gov.au/media/media\\_releases/2009/022](http://www.minister.dbcde.gov.au/media/media_releases/2009/022), p. 2, accessed 14 April 2009.

2.26 As the Global Financial Crisis evolved during the latter half of 2008, these concerns grew. With the value of the Australian dollar falling substantially, it became apparent that the \$4.7 billion would significantly erode the BAF, which had been established to 'provide a funding source for future investment in critical economic infrastructure in transport and communications such as broadband.'<sup>19</sup>

2.27 By early 2009, the 2008-09 budget surplus, which was to be a financial source for the BAF, had been transformed through the government's economic stimulus packages to a substantial budget deficit. During Additional Estimates, Minister Conroy advised that:

\$12.6 billion has already been allocated to BAF and further allocations were subject to budget circumstances. ... The lesser figure is due to revisions in budget surpluses. ... Of the \$12.6 billion, \$4.7 billion is for the NBN.<sup>20</sup>

2.28 With the cost of capital continuing to rise it became apparent that proponents would not find it easy to raise their share of the capital needed for the NBN.

2.29 Noting that the \$4.7 billion was coming from the taxpayers' pockets, submissions also raised concerns about how the government had determined that figure, and in particular whether there had been a cost/benefit analysis of the proposal. Professor Gans made the comment that '...as an economist, I am concerned as to whether a proper cost-benefit study has been conducted (either within government or industry).'<sup>21</sup>

2.30 This issue was taken up directly with the minister at a Senate Estimates hearing; however the minister repeatedly skirted the question, and answered that:

This is an election commitment and we will deliver on our election commitment. ...no ifs, no buts; it will be delivered.<sup>22</sup>

2.31 In direct contrast to this approach, the newly created government agency, Infrastructure Australia, was to examine infrastructure projects of national significance. These projects, although significantly lower in cost, were to be prioritised for implementation against publicised criteria through a process which included scrutiny by a rigorous government cost-benefit analysis. The NBN would not be required to undergo that same scrutiny.

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19 DBCDE, answer to Question on Notice, Question thirteen (a), 10 September 2008 (received 25 September 2008).

20 Senator the Hon. Stephen Conroy, Minister for Broadband, Communications, and the Digital Economy, *Estimates Hansard*, Senate Standing Committee on Rural and Regional Affairs and Transport, Canberra, 24 February 2009, p. 14.

21 Professor Gans, *Submission 15*, p. 2.

22 Senator the Hon. Stephen Conroy, Minister for Broadband, Communications, and the Digital Economy, *Estimates Hansard*, Senate Standing Committee on the Environment, Communications and the Arts, Canberra, 20 October 2008, p. 28.

2.32 The government has provided an estimated costing for the deployment of its new FTTP based network that is some ten times the level of government funding that was to be provided for the now terminated RFP NBN proposal.

2.33 Under the FTTP proposal, the burden of raising the capital must now be borne by the government, and ultimately the Australian taxpayer. The committee is hopeful that the implementation study will undertake and publish a detailed cost/benefit analysis of this massive cost imposition. This clearly would be in the interest of the government, given that the success of the proposed issuance of bonds and the eventual selling down of the government's interest after five years will be dependent on community and industry confidence of the financial viability of this project.

### *Open access*

2.34 One of the eighteen Commonwealth objectives for the RFP was that the NBN:  
...facilitates competition through open access arrangements that ensure equivalence of price and non-price terms and conditions, and provide scope for access seekers to differentiate their product offerings.<sup>23</sup>

2.35 It was widely acknowledged by the industry that the NBN was most likely to become a 'natural monopoly', and it was clear that through this objective the government intended to minimise the potential for anti-competitive behaviour by the NBN operator. The government reiterated throughout the RFP document that it wanted to ensure maximum flexibility for prospective proponents to develop solutions that would create competition and encourage innovation in service product offerings.

2.36 Although this was welcomed by the majority of stakeholders, there was criticism that the actual term 'open access' had not been clearly defined within the RFP, leaving it open to interpretation by individual operators. Many provided the committee with their version of open access arrangements<sup>24</sup>, while others outlined the benefits of open access to end-users and service providers alike. For example, Google highlighted the exponential growth of the internet over the last decade, which was facilitated through being founded on open access:

This open, non-discriminatory architecture [of the Internet] has given rise to fierce competition, constant innovation and unparalleled social benefits ... [and] was deliberately designed to empower end-users...<sup>25</sup>

2.37 This would be seen as an optimum outcome for the NBN by the government, all access seekers and all end users alike. However, the uncertainty caused by lack of a definition of open access was apparent. Concerns were raised that a successful bidder may use this lack of clarity to its advantage in relation to network access.

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23 DBCDE, *Request for Proposals to Roll-out and operate a National Broadband Network for Australia*, 11 April 2008, paragraph 1.3.1.10, p. 5.

24 See for example Optus, *Submission 19*, iiNet *Submission 3*, Regulatory Submission, pp9-10; WA DOIR, *Submission 2*, pp 1 & 3; Vodafone, *Submission 9*, pp 12-19.

25 Google, *Submission 29*, p. 14.

Critics of Telstra, for example, raised allegations of non-equivalent treatment of existing network access seekers and raised concerns that without a clear definition of 'open access', similar conflict would carry across to a new network.<sup>26</sup>

2.38 This concern was substantiated in a submission that quoted Mr Donald McGauchie stating that Australia should move:

...away from "open access" type requirements, in which competitors can free ride or cheap ride on incumbent's networks ... to one based on competition between fully vertically and horizontally integrated rivals...<sup>27</sup>

2.39 From the weight of evidence received on this issue, the committee urged the government to provide clarification of the term 'open access arrangements' to ensure that no proponent could interpret the term to the detriment of their competitors.

2.40 The government has stated that the new NBN will overcome these access issues because:

...it delivers separation between the infrastructure provider and retail service providers. This means better and fairer infrastructure access for service providers, greater retail competition, and better services for families and businesses.<sup>28</sup>

2.41 As noted in chapter 3, this measure has been welcomed by most in the industry, although the existing shortcomings of the access regime clearly need to be addressed in the interim. To this end, the Department has issued another Discussion Paper on regulatory reform that alludes to the reform of Part XIC of the *Trade Practices Act 1974* (TPA), which deals with the access regime, in the foreseeable future.

### ***Regulatory regime***

2.42 Stakeholder discussion of the open access interpretation was generally linked to what was seen as the urgent need for regulatory reform in the telecommunications industry. In a parallel process to the RFP, the government had invited submissions on suggested changes to the regime that might facilitate the implementation of the NBN. Over eighty submissions were provided within approximately ten weeks to the Department, in a clear affirmation of the need for regulatory change.

2.43 The industry welcomed the government's initiative, seeing the implementation of the NBN as a unique opportunity for the government to address the failings of the existing regime. An example of the common sentiment was expressed by Terria in their submission:

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26 See for example iiNet *Submission 3*, Regulatory Submission, pp9-10.

27 Competitive Carriers Coalition, *Submission 8(c)*, 'A Critique of Telstra's Regulatory Model for Broadband Networks Since 2005', p. 14.

28 Joint Media Release, [www.minister.dbcde.gov.au/media/media\\_releases/2009/022](http://www.minister.dbcde.gov.au/media/media_releases/2009/022), p. 2, accessed 14 April 2009.



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This unique opportunity is not simply about technology or consumer, it is first and foremost about setting up an industry environment where competition and, therefore, consumer benefits come first. ... [I]t needs to provide investor certainty and an effective regulatory framework.<sup>29</sup>

*The fatal impact of regulatory uncertainty*

2.44 However, not establishing the regulatory framework prior to the release of the RFP disadvantaged prospective bidders. In order to develop a clear business case within a viable proposal, a basic pre-requisite would be to possess an understanding of the legal requirements of the network being designed, particularly as the RFP required bidders to demonstrate their return on investment.

2.45 The RFP stated that one of the six evaluation criteria for proposals was:

The nature, scope and impact of any legislative and/or regulatory changes that are necessary to facilitate the Proposal;<sup>30</sup>

2.46 Consequently, prospective proponents had to risk basing their bid on what they believed to be a facilitative regulatory regime, unsure of whether the direction they proposed would be the one preferred by the government. Considering the cost of formulating and submitting a proposal, this was a considerable gamble bidders were forced to take. Mr Kevin Morgan summarised the risk aspect when giving evidence in Melbourne:

How can you possibly objectively assess a tender where the key regulatory inputs are not known? Regulation goes to the issue of risk and you cannot build a business case without understanding the risk because no-one will give you money. ...Until you have regulatory reform [and] have set regulatory rules you cannot go ahead.<sup>31</sup>

2.47 Also supportive of this view was the submission by iiNet, which strongly advocated the establishment of a new regulatory regime prior to the implementation of the NBN, pointing out that:

...the recent High Court judgement in *Telstra Corporation v The Commonwealth* (6 March 2008) reinforces the critical importance of setting in place a statutory access regime in advance of awarding any consortium the rights to build the National Broadband Network.<sup>32</sup>

2.48 The submission went further, predicting that the success of the NBN would be dependent on the government's ability to appropriately address the regulatory issues:

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29 Terria, *Submission 12*, p. 4.

30 DBCDE, *Request for Proposals to Roll-out and operate a National Broadband Network for Australia*, 11 April 2008, paragraph 1.4.1.3, p. 6.

31 Mr Kevin Morgan, *Committee Hansard*, Melbourne, 28 October 2008, p. 85.

32 iiNet, *Submission 3*, 'Access Seeker Requirements' 30 March 2008, pp 3-4.

The future access and regulatory regime will be a key determinant of the ability of the Federal Government to successfully implement its election policy and deliver on its commitment...<sup>33</sup>

2.49 Questions were also asked of the government as to how any contract for building the NBN could be signed without the successful bidder knowing the legislative framework under which their build would be operated, given that the RFP stated that there would be regulatory change to facilitate the NBN. The minister was closely questioned on this issue at Senate Estimates, with the most revealing answer being merely that:

...let us be clear: we will reach an agreement [with the winning proponent] and we will put forward – depending on the outcome of that [agreement] – any regulatory changes.<sup>34</sup>

2.50 The issue left unanswered was that even if this occurred, any changes to legislation still had to undergo the process of parliamentary scrutiny, with no guarantee that the legislative changes agreed between the government and the proponent would be agreed in parliament.

#### *Suggested changes*

2.51 This inquiry received a wealth of evidence on the changes required to telecommunications regulations and legislation. The main suggestions focused on Parts XIB and XIC of the TPA, the significant market power of the incumbent provider, Telstra, and how to remove the incentive for anti-competitive behaviour.

2.52 Some submitters went into great detail as to how the government should resolve the regulatory issues; however almost every submission received by this inquiry advocated some form of separation of Telstra, with the minimal requirement being to prevent Telstra from acting as both a wholesale and a retail provider of telecommunication services. Vertical integration had resulted in Telstra being able to increase and leverage its significant market power.

2.53 Despite the strong criticism of Telstra's alleged anti-competitive behaviour, many acknowledged that the fact that Telstra was legally conflicted lent a reasonable explanation for their position. As a service provider, Telstra was obligated to act in the best interests of its customers, both the Australian public and access seekers. Conversely, Telstra was now totally owned by its shareholders, with a consequential legal obligation to act in the best interests of its shareholders. Separation was seen by competitors as the logical solution to resolve this conflict.

2.54 Telstra itself stated throughout their submission to the Department that the current legislation was fundamentally flawed; however their resolution involved a

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33 iiNet, *Submission 3*, 'Access Seeker Requirements' 30 March 2008, p. 4.

34 Senator the Hon. Stephen Conroy, Minister for Broadband, Communications and the Digital Economy, *Estimates Hansard*, Senate Standing Committee on Environment, Communications and the Arts, Canberra, 20 October 2008, p. 18.

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softening of legislative requirements, or indeed their removal, including that the role and powers of the Australian Consumer and Competition Commission (ACCC) be weakened. Like other industry stakeholders, Telstra claimed that the uncertainty created by the current regime is problematic; however few would agree with what they claim as being the cause:

The central problem is regulatory uncertainty. The cause of this uncertainty is the excessive discretion vested in the ACCC in both determining its own remit by declaring which services will be regulated and then in determining the terms of access.<sup>35</sup>

2.55 Under Part XIC, the current process for access seekers to have their terms of access determined uses a negotiate/arbitrate model. A common complaint was that this model assumed that both parties would strive toward the ideal win/win outcome, but due to Telstra's legal conflict, it was not in their interest to readily negotiate. This led to a practice that was referred to as 'gaming' the regulatory regime, which resulted in lengthy delays to finalising access conditions, including prices. The consequence of this was added uncertainty for service providers, and some evidence identified that this in turn stifled investment and innovation throughout the industry. As Optus commented:

The negotiate/arbitrate model under Part XIC has proven to be a failure. It has provided Telstra with both the incentive and the means to game the system to its advantage.<sup>36</sup>

2.56 The provisions of Part XIB that empowered the ACCC with alternative mechanisms to address anti-competitive behaviour were also widely criticised as being ineffective. Even when Telstra was issued with an anti-competitive notice, any monetary amount that they may be required to pay would have been small, likened by Optus to a 'minor speeding ticket.' Due to the convoluted processes involved under Parts XIB and XIC, which ultimately have little or no deterrent effect, Optus claimed that the ACCC's powers to regulate access were:

...often ill-defined and limited by various rights of appeal. ... The legal strait jacket within which the ACCC has to operate is demonstrated by the ACCC's recent revelation that it is currently involved in 47 legal actions initiated by Telstra.<sup>37</sup>

2.57 Predictably, this totally contradicts claims by Telstra that the ACCC is the causal factor creating delays and consequential uncertainty for the industry.

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35 Telstra, *Public submission on the roll-out and operation of a National Broadband Network for Australia*, 25 June 2008, p. 23.

36 Optus, *Submission 19*, p. 22.

37 Optus, *Submission 19*, p. 24.

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*Separation and underpinning principles for regulation*

2.58 A more objective submission from outside the telecommunications industry recommended that a number of basic principles should guide the development of any new NBN regulatory framework. The submission stated that the objective for such a framework should be to achieve a 'reasonable balance between protection and regulatory cost', should achieve 'competitive neutrality, transparency and have minimal overlap and duplication', and that 'regulation should be outcomes based rather than process based'.<sup>38</sup>

2.59 Throughout this inquiry it has been stated repeatedly that the issues of open access, appropriate regulation and vertical separation were closely inter-related. As one witness stated:

...it is the structure of the industry rather than simply the regulatory settings that we have at the moment that makes it difficult, if not impossible, to have open access. ... It is not so much the regulatory settings as it is the structure of the industry that militates against open access arrangement.<sup>39</sup>

2.60 The prime objective and major component of the current regulatory regime is to promote competition through open access and prevent anti-competitive behaviour. It was commonly held that by structurally separating Telstra, their incentive for non-competitive behaviour would be removed, resulting in open access on equivalent price and non-price terms, with the consequential reduction in the amount and extent of regulation required.

2.61 The Chief Executive Officer (CEO) of Axia NetMedia had a different perspective on how to resolve the current regulatory issues without forcing any separation and without any regulatory change. His company has implemented broadband networks in Alberta Canada, France and is about to deploy fibre in Singapore. All three networks have been based on a simple but powerful principle, which is: 'Competing With Your Customer Does Not Work'.<sup>40</sup>

2.62 The reasoning is that, if a network owner is also supplying network services, they are in direct competition with their own customers, i.e. other service providers, which provides the incentive for anti-competitive behaviour against those customers. This is a business model that clearly would not work in mainstream retail businesses. However, a network company that does not also offer retail services does not need to compete with other service providers; on the contrary, their success would then depend on the ongoing business of service providers. Mr Price concluded that:

...to get a high performing end result and choice for the end users, the party who has the next generation network should not be competing with its own customers.

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38 Western Australian Chamber of Commerce and Industry (WA CCI), *Submission 17*, p. 2.

39 Mr Matthew Healy, Chair, Competitive Carriers Coalition (CCC) *Committee Hansard*, Canberra, 8 October 2008, p. 2.

40 Axia NetMedia, *Submission 33*, p. 1.

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That is quite different to saying that the incumbent must structurally separate. ...if you think of the three places we did this, the government did not require the incumbent in any of those places to structurally separate, but they got a structurally separated outcome ... from a party other than the incumbent.<sup>41</sup>

2.63 This principle seems to underscore views commonly stated to this committee that separation of the operator from upstream retail services would reduce the need for, and extent of, regulation of the industry.

2.64 As mentioned earlier, the government has moved to comprehensively address the 'shortcomings and inherent limitations'<sup>42</sup> of the current regulatory regime in a two-pronged approach. First, the new NBN company will provide wholesale-only services, ensuring there is separation between the infrastructure provider and service providers, which will consequently remove the incentive for anti-competitive behaviour by any NBN operator. The second measure is the promise of regulatory reform to relieve the existing industry stresses caused by these regulatory 'shortcomings' while the NBN is being implemented.

## **RFP process and timeframes**

### *A flawed process*

2.65 The RFP process itself was criticised in a number of diverse areas that were detailed in the Interim Report of this inquiry, which was tabled in the Senate on 2 December 2008.

#### *Lack of transparency*

2.66 Most notable and damaging for the government was the widely perceived lack of transparency of the process, despite the earlier claim by the government to the contrary. The proclaimed probity constraints by the minister, his department and the ACCC to provide additional detail of the process and underlying policy development drew ongoing criticism, with stakeholders and the industry in general expressing great concern that the government was providing insufficient detail on how such a large portion of taxpayer funds would be spent.

2.67 This unwillingness was legally underpinned by what became referred to as the 'gag order' within the RFP, which effectively prevented any prospective proponents from providing the committee with details of their proposals or discussions with the Department. The RFP stated that:

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41 Mr Price, Axia NetMedia, *Committee Hansard*, 24 November 2008, pp7-8.

42 Joint Media Release, [www.minister.dbcde.gov.au/media/media\\_releases/2009/022](http://www.minister.dbcde.gov.au/media/media_releases/2009/022), p. 2, accessed 14 April 2009.

Proponents should not communicate with or solicit information in relation to the RFP process from any government employee (or contractor), Minister or Minister's adviser other than the Contact Officer.

The Commonwealth may preclude a Proposal from further consideration if the Proponent does not comply with any requirement of this clause 10.7, or based on any investigation carried out under this clause 10.7.<sup>43</sup>

2.68 Criticisms representative of views expressed to the committee include those from Dr Ross Kelso when he commented:

A prime goal in selecting the NBN provider and managing ongoing deliverables should be to ensure full transparency of process and public accountability for outcomes. ... [t]ransparency and accountability are crucial factors.<sup>44</sup>

2.69 Following the closure of bids for the RFP, the Senate called for the reports of the Panel of Experts and the ACCC to be made public on the first day of sitting following the announcement of a winning bid.<sup>45</sup>

2.70 Since the Rudd Government announcement that the RFP process was being terminated, the Opposition has called for there to be a full review of the failed RFP process by the Auditor General. On 7 May 2009 *the Australian*<sup>46</sup> reported that there would be a 'preliminary review' of the government's terminated RFP process.

2.71 While the committee welcomes this preliminary review, the committee urges the government to ensure a full review of the terminated RFP process is conducted by the Auditor General, to be commenced before the end of 2009.

### *Evolving timeframes*

2.72 The original timeframes quoted in the RFP for achievement of the proposed project milestones were quickly superseded; difficulties arose in the obtaining of proponent network information, which was designed to allow proponents access to equivalent network information in order to determine their network infrastructure requirements. The delay in obtaining this information pushed back the closure date for the RFPs from 25 July to 26 November 2008, one month after the originally scheduled date for the government's final decision, making the government's promise of a roll-out commencing by the end of 2008 impossible to fulfil.

2.73 Criticism was also levelled at the timeframe for the evaluation of the bids following the closure date on 26 November 2008. The RFP provided that the assessment process would be undertaken over an eight week period, which would

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43 DBCDE, *Request for Proposals to Roll-Out and Operate a National Broadband Network for Australia*, 11 April 2008, paragraphs 10.7.5-6, p. 38.

44 Dr Kelso, *Submission 24*, p 8.

45 See Senate Journal No 54, 4 February 2009, p. 1542.

46 *The Australian*, 7 May 2009, p. 23.

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include a parallel assessment process and report by the ACCC to the Panel of Experts within six weeks of the closure date.

2.74 Following evaluation of the proposals, the Expert Panel was to present the minister with a report before the end of January 2009. The industry expectation was that the minister would make an announcement shortly after Parliament resumed for 2009. However, the waiting game was to continue for several months.

2.75 After holding the industry in limbo for almost twelve months, the minister participated in the recent joint announcement of the new NBN initiative on 7 April 2009, terminating what many had complained was a flawed RFP process.

### *Transition planning*

2.76 Concerns have been expressed to this committee that the transition to a new broadband network would be risk-laden, requiring thorough planning and consideration of all stakeholders involved, regardless of who the new operator would be and/or the technology platform that might be utilised.

2.77 The possibility that a FTTN deployment would result in a switch-over that would bypass the local exchange was very real, particularly if the incumbent were to build and operate the NBN. One of the consequences would be that competitor equipment installed in those exchanges would become 'stranded assets', with the possibility of the government having to compensate equipment owners for their losses.

2.78 iiNet noted that a managed transition plan could mitigate many transition concerns, stating that '[t]ransitional arrangements are essential and should be aimed at meeting public policy objectives rather than shoring up anti-competitive structures.'<sup>47</sup> Mr Hicks from Adam Internet also advocated for a migration plan with a specified period of time before the switchover would be mandated:

...there would have to be a migration period, so that we all agree that,...everyone will be on the new network in, say seven years time. The option of changing is up to the customer any time in that seven years. ... It would be a managed migration.<sup>48</sup>

2.79 This period would also allow companies time to depreciate and retire their assets in a commercially viable manner. Another solution with similar results would be if the NBN was rolled-in from the unserved areas, again allowing competitors with equipment in exchanges to retire their assets over the period of time before the NBN reached the metropolitan areas.

2.80 Stranding assets was not the only transitional issue. The physical, manually-intensive process required to transfer customers from one network to the NBN was

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47 iiNet, *Submission 3, Regulatory Submission on the Requirements for an Open Access National Broadband Network*, June 2008, p. 6.

48 Mr Hicks, Adam Internet, *Committee Hansard*, Sydney, 7 October 2008, p. 45.

mentioned by Mr Hicks, highlighting that there was a human intervention factor to be considered:

...there are an awful lot of customers who have to have their database physically changed and their records moved. There is hard wire [involved]. There is human intervention. Every time someone changes one of those, you end up with the possibility of stranding customers as well.<sup>49</sup>

2.81 A critical factor in successful transition planning was stated to be the need for improved coordination of infrastructure planning across the three tiers of government, with particular references to the economic efficiencies that could be gained through effective synchronisation of efforts. Professor Walter Green called for each state to have a telecommunications plan identifying future development needs and infrastructure requirements, so that, as a minimum, the conduits for fibre deployment can be included in future developments. Professor Green advocated for there to be 'some kind of regulatory and legal support' to ensure this coordinated planning of development occurs:

The attitude that telecommunications legislation or telecommunications is only a federal issue needs to be changed ... The Federal government is not there to do state planning.<sup>50</sup>

2.82 In order for this coordination to be fully effective and successful there is a need for increased consultation between all three levels of government, industry and consumers. The *State of the Regions Report 2008-09*, produced by National Economics for the Australian Local Government Association (ALGA), was critical of the lack of coordination across jurisdictions in all economic development and infrastructure planning. This report provided contemporary references to the Global Financial Crisis, highlighting a 'troubling convergence of factors that will have an impact on regional economic development'.<sup>51</sup>

2.83 One of these factors was stated to be the 'lack of progress in developing the National Broadband Network'<sup>52</sup>, with the report urging that a more holistic approach is required by governments and regions when seeking resolutions to what may otherwise seem quite disparate issues. This clearly echoes the sentiments of Professor Green, among others.

2.84 The Rudd Government already has in place a number of agencies and means by which this greater level of coordination should be readily achievable. Apart from the Council of Australian Governments (COAG) forum, the Rudd Government has established Infrastructure Australia, tasked with developing a national infrastructure priority list that is to be provided to COAG for consideration. National infrastructure

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49 Mr Hicks, Adam Internet, *Committee Hansard*, Sydney, 7 October 2008, p. 44.

50 Professor Walter Green, Director, Communications Expert Group and ATUG *Committee Hansard*, Perth, 6 November 2008, p. 58.

51 *State of the Regions 2008-09*, p. (i).

52 *State of the Regions 2008-09*, p. (i).



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investment is to be monitored, and routinely reported to COAG, by Infrastructure Australia.

2.85 Within Infrastructure Australia itself, the Major Cities Unit has been established in the recognition that:

The issues surrounding the infrastructure and governance of our major cities are complex and require the input of Local, State and Federal government, the integration of services and infrastructure bodies, and industry and community participation. The Unit will provide a more coordinated and integrated approach to the planning and infrastructure needs of major cities. ... It will be central to the development of a strong relationship across the Commonwealth Government, all levels of government and the private sector.<sup>53</sup>

2.86 In addition, ALGA has extensive and widely dispersed expertise in their membership, and no doubt there are other similar conduits that could increase coordination across jurisdictions. The committee urges the government to fully leverage the existing forums of coordination to ensure the NBN initiative is given optimal opportunity for effective and economically efficient implementation throughout the life of this project.

### *Consultation process*

2.87 Throughout the inquiry process witnesses have called upon the government to increase the level of consultation across the industry and across jurisdictions. The committee acknowledges that a substantial submission process was an integral component of the RFP process. Although this enabled comment to be made, it did not provide for any government responses to the submission process and consequently did not fully substantiate the government's repeated declaration that the RFP process was open and transparent.

2.88 Dr Kelso reiterated his concerns at the Brisbane hearing in relation to the lack of opportunity for industry input, particularly in relation to the changes to the regulatory regime, which were (and still are) likely to be substantial:

Until now, all the changes that the telecommunications have undergone ... have been supported by significant public disclosure and discussion.

The only time at which there will be public exposure about the regulatory framework will be when parliament resumes next year [2009] and presumably changes to the legislation will be sought.<sup>54</sup>

2.89 The committee's Interim Report concluded that the government needed to 'incorporate appropriate and timely opportunities for consultation with the industry'<sup>55</sup> and across all jurisdictions, to ensure full consideration of stakeholder concerns that

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53 <http://www.infrastructureaustralia.gov.au/mcu.aspx> , accessed 2 May 2009.

54 Dr Kelso, *Committee Hansard*, Brisbane, 21 November 2008, pp 18-19.

55 *National Broadband Network – Interim report*, p. 65.

could then inform both the drafting of final legislation and the development of transitional planning and implementation of the NBN.

2.90 Consultation is essential in planning the deployment of the NBN. As mentioned above, the deployment of an infrastructure project of this proportion and national significance calls for the highest degree of coordination and collaboration across all jurisdictions and also across all stakeholder businesses within the telecommunications industry.

2.91 Again, the committee urges the government to ensure agencies such as Infrastructure Australia, its Major Cities Unit and the extensive and diverse membership of ALGA, together with representation from business, are involved to their fullest capacity, to allow seamless coordination and cooperation across jurisdictions, industry and businesses impacted by the deployment of the NBN.

### **Evidence and events post RFP closure**

2.92 The now terminated Request for Proposals (RFP) closed at noon on 26 November 2008, with six bidders lodging their proposals for assessment over the following eight weeks by the Panel of Experts, which would incorporate advice received from the ACCC. Six bids were lodged; the four bidders proposing a national solution were (in alphabetical order): Acacia; Axia NetMedia; Optus; and Telstra; the Tasmanian Government and TransACT lodged bids for state solutions, covering Tasmania and the Australian Capital Territory (ACT) respectively.

### ***Controversial exclusion of Telstra***

2.93 Due to the requirement for all proponents and all government personnel involved with the RFP not to discuss details of their proposal at the risk of exclusion from the RFP process, very little was known about five of the proposals that was not already in the public arena. On the other hand, when Telstra submitted their proposal, they provided a Media Release and published their twelve page letter to the minister that outlined basic objectives of their proposal.

2.94 This letter provided what Telstra referred to as a 'compelling proposition' for the government's consideration, but reiterated their concerns in relation to the RFP process that they believed had not been considered by the government, stating that:

Unfortunately, these issues have not yet been able to be addressed in a manner that would enable Telstra to submit its fully detailed bid under the RFP today.<sup>56</sup>

2.95 The remainder of Telstra's letter to the minister elaborated on these concerns and set out what virtually amounted to 'conditions of participation' that the government would need to meet before Telstra would submit their full proposal.

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56 *National Broadband Network – Telstra Proposal*, p. 2.

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2.96 Telstra referred to these conditions of participation as 'key enablers' that would be required to be in place before Telstra would commit to building the NBN; these key enablers were listed as:

- no further separation of Telstra (including no sub-loop unbundling) over the life of the project;
- certainty of NBN build footprint, rollout regulations and technology commitments;
- Telstra retaining all its Intellectual Property, ownership and management of its network across Australia;
- regulatory certainty (of wholesale pricing, services and processes) in practical terms for the life of the project;
- there being no further dislocation in financial markets or an economic contraction;
- more rigorous confidentiality arrangements;
- agreement to high level negotiations with key decision makers; and
- a fresh contractual starting point.<sup>57</sup>

2.97 No one in the industry would deny that Telstra's highly skilled workforce and extensive existing infrastructure made it highly qualified as a builder of the NBN. Telstra concluded that these capabilities ensured that it would not require the 'Commonwealth as a joint venture partner', but that it was 'ready to self-fund the NBN (at a cost of up to \$5 billion)', to build the NBN in 'essentially the 5 major cities'. However, Telstra noted that if the government were to provide the \$4.7 billion 'as a loan at concessional interest rates'<sup>58</sup>, then Telstra could extend the NBN footprint to reach between 80 and 90 per cent of the Australian population.

2.98 Some detail of their proposal was provided by Telstra in this document, making it apparent to all that their final proposal would not meet the RFP requirement of 98 per cent fibre, but would instead aim for a footprint reaching 80 to 90 per cent of the Australian population. Telstra provided a basic pricing plan for a maximum 1 Mbps broadband service at \$29.95 per month for existing Telstra voice customers, or \$39.95 for non-customers. Australians were left to wonder what price brackets would be applied for the RFP's requisite minimum download speed of 12 Mbps, as details of the higher download speed prices were not provided.

2.99 However, as a result of Telstra's failure to submit a small and medium participation plan in compliance with Clause 10.9 of the RFP, the Commonwealth announced on 15 December 2008 that they would be excluding Telstra from further consideration in the RFP evaluation and assessment process.

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57 See *National Broadband Network – Telstra Proposal*, p. 3., and subsequent discussion.

58 *National Broadband Network – Telstra Proposal*, p.3.

*Reaction to Telstra's exclusion*

2.100 Telstra's subsequent Media Release disagreed with the government's reason for its exclusion:

Telstra considers it has fully complied with the RFP requirements (which did not require a SME Plan to be lodged as part of the RFP Proposal itself) and that the Commonwealth has used a peripheral issue to exclude Telstra. ...Telstra provided its SME Plan to the Government in early December and, in Telstra's view, in accordance with the RFP. The Commonwealth could hardly have dreamed up a more trivial reason to exclude Telstra from the NBN. This is a process that seemingly excludes bidders on such trivial and legally questionable technicalities but doesn't take any action [on other bidders] on material issues such as financing and having the technical capability to build the network.<sup>59</sup>

2.101 As could be predicted, the government's decision was heralded by Telstra's competitors as a bold but appropriate response to what was seen generally by the industry as a very inadequate response by Telstra to the RFP.

2.102 The committee heard from both Telstra and their main competitor, Optus, at the public hearing held in Sydney on 3 March 2009. Mr Maha Krishnapillai, the Director of Government and Corporate Affairs for Optus, indicated that the government was correct in their decision to exclude Telstra from the NBN, stating that the fixed broadband market in Australia:

...is tilted heavily in favour of the incumbent and has been for many years. ... It is time for the firm hand of the government to put the national interest above private shareholder interest and create the conditions necessary for a vigorously competitive fixed line market.<sup>60</sup>

2.103 This comment was obviously directed at Telstra's conflict between the best interests of their customers and those of their shareholders, with the latter clearly the favoured party in recent years.

2.104 However, the exclusion of Telstra caused an immediate vote of no-confidence in Telstra's stance by their shareholders, with share prices falling dramatically by 11.6 per cent that day, the biggest one-day percentage fall since its listing in 1997. Share prices have continued to tumble, at one point falling for the first time below the \$3.00 mark. Even the announcement by Telstra of the \$250 million investment in the Hybrid Fibre Coaxial (HFC) network, failed to significantly rally the share price.

2.105 There is of course public interest in Telstra's share price, with the Future Fund holding a 16 per cent share in Telstra. The committee notes that there have been discussions between the executives of the Future Fund and Telstra since the government's decision to exclude Telstra.

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59 Mr Donald McGauchie, Telstra Chairman, Media Release, 15 December 2008.

60 Mr Maha Krishnapillai, Optus, *Committee Hansard*, Sydney, 3 March 2009, p. 35.

2.106 At the March Sydney hearing, the committee put to Mr Krishnapillai that, as Telstra was the incumbent carrier, their exclusion on what was termed as 'something of a technicality', surely meant that the RFP process could no longer be 'properly described as a competitive tendering process'.<sup>61</sup> Mr Krishnapillai was quite emphatic in his disputation of that suggestion:

...I categorically disagree, with respect, that Telstra needs to be part of this process. It had its opportunity. It chose to submit a 12-page media release, compared to the 1,500-page proposal [Optus] have put forward ... Telstra had its chances; it chose not to participate. The Government cannot, in our view, and should not have any accord with a party who wants to put its interests above the national interests, which is clearly what Telstra has chosen to do.<sup>62</sup>

2.107 Over the Christmas-New Year holiday period, media speculation continued as to what the NBN winning bid might comprise. With the few details available, the concept of a consortium being formed by the remaining three national bidders was touted and debated by the media:

...another emerging option is that the panel could suggest taking the best elements of all bids – including state-based bids in Canberra and Tasmania – and bring them together as one consortium to deliver the best network.<sup>63</sup>

2.108 It was suggested that this may be a face-saving opportunity for the government in that it could, under the guise of forming a consortium, bring Telstra back into the NBN negotiation tent. Meanwhile, Telstra continued its defiant stance, with the CEO, Mr Sol Trujillo, seen to threaten the commercial viability of the NBN; *The Australian* stated that Mr Trujillo had made comments that:

Telstra would effectively deny the owners of the NBN a customer base by migrating its retail customers to its own networks before the [NBN] project could be completed.<sup>64</sup>

### *The Panel's report*

2.109 On 20 January 2009 the Panel of Experts provided their much anticipated report to the government containing their assessment of the remaining five bids. Speculation mounted in anticipation of the government announcement and whether the contents of the Panel's report, or that of the ACCC, would ever receive public scrutiny.

2.110 On the same day, there came the surprise resignation of one of Mr Trujillo's key advisors, who would return to the United States of America. Mr Greg Winn was

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61 See *Committee Hansard*, Sydney, 3 March 2009, pp 35 & 36.

62 Mr Krishnapillai, Optus, *Committee Hansard*, Sydney, 3 March 2009, p. 36.

63 [www.australianit.news.com.au/story/0,25197,24942087-15306,00.html](http://www.australianit.news.com.au/story/0,25197,24942087-15306,00.html), accessed 21 January 2009.

64 *The Australian*, Wednesday 14 January 2009, p. 19.

the second Trujillo-appointed advisor to exit Telstra, following Mr Phil Burgess' departure in late August 2008. There was almost immediate speculation over the tenure of the CEO himself.

2.111 Although Telstra believed it had been wrongfully excluded from the NBN process, it quickly moved to demonstrate that they would not be impacted as a business by this decision through a number of self-promotional announcements. These included their intention to immediately commence an upgrade of their existing HFC network, commencing in Melbourne and extending to other major capital cities. At the end of January 2009, Telstra announced that it would deploy Ethernet backhaul upgrades to its Next G wireless network. With its entire Next G network already capable of maximum download speeds of 21 Mbps, Telstra confirmed plans to have speeds incrementally increased to 42 Mbps by 2010. With the remarkable increase in uptake of wireless broadband across Australia, even in the last six months of 2008, this was a strategically-timed announcement.

2.112 Telstra's rival, Optus, was quick to pour water on this initiative, remarking in *Communications Day* that:

This is another example of Telstra misleading Australian businesses and consumers ... The fact is customers will need to buy a new modem and live/work ... to take advantage of these 'theoretical' speeds. For all the hype that Telstra has made ... not a single customer has benefited from these speeds as modems haven't been available.<sup>65</sup>

2.113 There was comment in the New Year that Telstra was perhaps softening its defiant stance. This was particularly noted following the announcement that Mr Trujillo would be stepping down as Telstra's CEO by 30 June 2009, a year shy of his five year term. This was considered by some to be a risky announcement due to the fact that there was no clear successor leaving Telstra with what could be termed a lame duck leader for over five months. The issue was resolved when Telstra announced its new CEO was Mr David Thodey, who brings extensive experience in the ICT and telecommunications sectors, and has been with Telstra since 2001.

2.114 In his speech to the National Press Club on 26 February 2009, Mr David Quilty, Managing Director of Public Policy and Communications, presented a more conciliatory stance by Telstra. Mr Quilty stressed the need for governments, the ICT sector and business sectors to develop a new mindset that would facilitate 'the economy-wide enabling powers of information technologies.'

Increasingly the world's largest Telecoms companies and governments are now entering into pragmatic win-win partnerships to bring on investment in next generation networks. ... win-win partnerships use government regulatory, fiscal, tax and spectrum levers to both the supply and demand sides to stimulate and maximise commercial investment. ...<sup>66</sup>

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65 Mr Andrew Buay, Optus Managing Director, *Communications Day*, 18 February 2009, p. 1.

66 Mr Quilty, Telstra, Address to the National Press Club (NPC Address), 26 February 2009.

2.115 At the end of his speech, Mr Quilty received the inevitable question relating to Telstra's exclusion from the NBN. In response, Mr Quilty reiterated that Telstra had 'moved on', but that Telstra would continue to compete strongly in the market. However, in an indication that, although they were perhaps now ready to negotiate for a win-win outcome, it would be no easy battle for the government:

By moving on means that we would continue to compete vigorously in all markets for all customers. So anyone who builds an NBN who thinks there is some decree or there is some certainty that Telstra can be relied upon as an anchor tenant I think needs to rethink their business case.<sup>67</sup>

#### *Further public hearings*

2.116 The tragic and devastating Victorian bushfires in February 2009 may have provided an additional and understandable need for the NBN announcement to be delayed further, as there was still no announcement when the Senate Estimates hearings commenced on 23 February 2009. However, potential questions regarding the evaluation process were headed off by the minister making an opening statement that:

Discussion of the contents of proposals, release of information relating to the evaluation and the evaluation methodology or speculation on the possible outcomes from the process prior to a public announcement could be misconstrued and could undermine the integrity of the process.<sup>68</sup>

2.117 The minister did confirm his 'ambition' to provide an outcome of the process in March and that the government 'will deliver on our election promise in full.'<sup>69</sup> The Estimates committee closely questioned the minister on the process leading to Telstra's exclusion, but were able to extract little detail apart from the fact that advice from five separate legal counsels led to the Chair of the Panel of Experts, Ms Patricia Scott, in her role as Secretary of the Department, making that decision.

2.118 Early in March this committee held two additional public hearings, gathering evidence in the main from previous witnesses to determine their opinions and options following the exclusion of Telstra from the RFP process. With the appearance of both Optus and Telstra publicised, these hearings received significant media attention.

2.119 Mr Maha Krishnapillai took the opportunity to advocate the four key pillars that Optus believes should underpin any regulatory changes, which were listed as 'structural separation, open access, true cost based pricing and a clear and

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67 Mr Quilty, Telstra, NPC Address, 26 February 2009.

68 Senator the Hon. Stephen Conroy, Minister for Broadband, Communications and the Digital Economy, *Estimates Hansard*, Senate Standing Committee on Environment, Communications and the Arts, Canberra, 23 February 2009, p. 102.

69 Senator the Hon. Stephen Conroy, Minister for Broadband, Communications and the Digital Economy, *Estimates Hansard*, Senate Standing Committee on Environment, Communications and the Arts, Canberra, 23 February 2009, p. 103.

unambiguous oversight role for the ACCC.<sup>70</sup> Apart from being highly supportive of the decision to exclude Telstra from the NBN process, Mr Krishnapillai strongly stated that the Optus bid would fully comply with the requirements of the NBN, but added that Optus believed that:

A country of Australia's size with its population, in our view, cannot support multiple fibre networks. ... The alternative I believe we have in the Australian context is to have one utility rate of return, a fibre network that achieves 98 per cent coverage, or a couple of smaller networks that achieve coverage in metropolitan areas.<sup>71</sup>

2.120 Mr Krishnapillai went on to explain the consequent need for the ACCC to have a clear oversight role:

...if you are going to have a monopoly network, and the economics and commercial rationale justify that, then you must have a genuine open access, regulated by the ACCC, in the national interest, with a utility rate of return for that network.<sup>72</sup>

2.121 When asked his views on whether the advice from the Panel of Experts and the ACCC should be made public, Mr Krishnapillai answered in the affirmative:

We have certainly said quite clearly we believe it is appropriate that the minister should release the expert panel report and the ACCC report.<sup>73</sup>

2.122 Mr Krishnapillai restated that it was their preference to roll-in the deployment of the NBN to the cities to 'address those areas of Australia that either do not have broadband or need broadband competition.'<sup>74</sup> Another witness in Sydney, Ms Deanne Weir from AUSTAR, concurred with this view when she spoke of the difficulties her company had encountered when attempting to build wireless access networks into regional areas.

We should really be focusing on where the true need is for these services, and the true need is in regional and rural areas where there just is not necessarily a [commercially viable business] case.<sup>75</sup>

2.123 When Telstra appeared before the committee in Sydney, rather than provide the customary opening statement, Mr Quilty presented the committee with a previously unseen, seven-page document, entitled *Critical issues to be addressed in the NBN decision*. Stating that, despite its exclusion from the NBN process, 'Telstra

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70 Mr Krishnapillai, Optus, *Committee Hansard*, Sydney, 3 March 2009, p. 35.

71 Mr Krishnapillai, *Committee Hansard*, Sydney, 3 March 2009, pp 38-39.

72 Mr Krishnapillai, *Committee Hansard*, Sydney, 3 March 2009, p. 39.

73 Mr Krishnapillai, *Committee Hansard*, Sydney, 3 March 2009, p. 47.

74 Mr Krishnapillai, *Committee Hansard*, Sydney, 3 March 2009, p. 43.

75 Ms Deanne Weir, Group Director, Austar United Communications Limited, *Committee Hansard*, Sydney, 3 March 2009, p. 58.



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retains a vital interest' in the project, Mr Quilty explained that the purpose of their tabled document was:

To inform people who are interested in this issue about what we see as the range of key matters that should be considered and deliberated upon in terms of the decisions that are being taken.<sup>76</sup>

2.124 Among the 'key matters' expanded upon in the document were the risks relating to the technical experience, knowledge and skill levels required to design and build the NBN; the financial risks in the current global economic climate; operation and technology risks; possible security risks; and regulation, pricing and competition risks.<sup>77</sup>

2.125 When Mr Quilty was asked what Telstra was anticipating as a likely outcome of the NBN process, although he stated that Telstra had had no contact with the government since their exclusion in December, his response was rather prophetic:

In terms of what particular models might be, one possible model I see is one where an alternative wholesale network is committed to by the government. The equity owners may well be the government and a number of, if not all, the remaining bidders through the RFP.<sup>78</sup>

2.126 Mr Quilty went further to explain that:

...you would envisage that such a network would involve a combination of fibre, wireless, or backhaul for wireless, and satellite and that a number of those who might be investing in a wholesale only network, particularly Optus, would also be retailing off that network ...<sup>79</sup>

2.127 Mr Quilty also elaborated on what he believed were the risks of any further separation of Telstra:

Our view is that structural separation increases costs, reduces investment incentives, makes it more complex to provide reliable end-to-end services and it has not been demonstrated to work anywhere in the world. ... We see it as largely a campaign by others in the industry to do harm to Telstra. We do not see any benefit for end-users...<sup>80</sup>

2.128 Dr Tony Warren added that in his view, now that Telstra has been excluded from the NBN process, 'the separation of Telstra is off the agenda.'<sup>81</sup>

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76 Mr David Quilty, Managing Director, Public Policy and Communications, Telstra, *Committee Hansard*, Sydney, 3 March 2009, p. 85.

77 See *Critical issues to be addressed in the NBN decision*.

78 Mr Quilty, Telstra, *Committee Hansard*, Sydney, 3 March 2009, p. 86.

79 Mr Quilty, Telstra, *Committee Hansard*, Sydney, 3 March 2009, p. 87.

80 Mr Quilty, Telstra, *Committee Hansard*, Sydney, 3 March 2009, p. 90.

81 Dr Tony Warren, Executive Director, Regulatory Affairs, Telstra, *Committee Hansard*, Sydney, 3 March 2009, p. 92.

2.129 Mr Paul Budde used his second appearance before the committee to highlight the need for greater coordination of planning and infrastructure development in all areas. Mr Budde said that, in this current climate where governments were tending to provide economic stimulus funding for large infrastructure projects, they should be looking for the 'multiplier effect'. He believed that governments could leverage the opportunities now existing and explore:

...how we can solve more problems with one investment. ... The government needs to think trans-sector and start addressing issues not in silos but as an overarching model.<sup>82</sup>

2.130 When asked by the committee how the government should provide leadership in such trans-sector thinking, Mr Budde suggested that the government should provide the vision for innovative trans-sectoral projects, but then step back and allow industry to work out appropriate solutions:

If you [the government] have got the vision and you say, 'Guys, infrastructure, \$40 million: do something with water, do something with electricity, do something with broadband ... But we miss the vision from the government. The government is thinking in silos ... But if you turn around and say, 'The infrastructure will have to be used to get a multiplier effect,' then suddenly you will find that these people ... will start working together.<sup>83</sup>

2.131 Professor Walter Green also reappeared before the committee, commenting that the NBN should be technologically neutral, and advocating FTTP in greenfield developments:

...in terms of public policy goals ... the provider or the NBN should be allowed to use a combination of all technologies. However, regarding greenfield sites, I have been involved in a number of projects where we found it cheaper to provide fibre to the premises in residential estates. We have been doing this for more than four years in Western Australia.<sup>84</sup>

2.132 Professor Green supported the previously discussed Axia principle that the successful NBN provider should not be able to compete with its retail customers, pointing out that this is ultimately in the long-term interest of end-users. There were several other interesting issues raised by Professor Green, in particular the issue of establishing a mediator to deal with day-to-day interconnection issues that will arise during the transition to the new network. Highlighting that the successful NBN builder will be required to work with multiple carriers, including Telstra, Professor Green explained that:

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82 Mr Paul Budde, *Committee Hansard*, Sydney, 3 March 2009, p. 61.

83 Mr Budde, *Committee Hansard*, Sydney, 3 March 2009, pp 65-66.

84 Professor Green, Director, CEG and ATUG, *Committee Hansard*, Sydney, 3 March 2009, p. 15.

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If there are these grey access interconnection issues then it is important that the government establish a mediator who has the authority to issue a quick resolution ...<sup>85</sup>

2.133 When questioned on what mechanism the mediator would be able to utilise to enforce their decisions on what, by his own admission, are 'grey access interconnection issues', Professor Green stated it should be:

The threat of structural separation ... much along the same lines as New Zealand and in a few other countries. Secondly, ... [w]e need a stronger reinforcement, ... a condition of licence ... [of] the carrier ... [with] penalties for not doing so. ... if you do not have mediation plus the ability to deal with it case by case you are going to have great problems delivering the NBN.<sup>86</sup>

2.134 On the issue of separation, Professor Green noted that structural separation removes the incentive for an incumbent to manipulate prices and conditions in their favour, commenting that:

...when you have something structurally separated you actually get better and more efficient use of your infrastructure, because the provider is not dealing with customers. All he needs is to focus on getting as many customers as possible and as much traffic. That is the successful {NBN} business model.<sup>87</sup>

2.135 Mr Ed Willett also appeared in Sydney, but pointed out that as a Commissioner of the ACCC, he was constrained as to the questions he could answer due to the live RFP process. However, Mr Willett did provide the committee with a useful comparison between structural and functional separation:

...full structural separation ... is designed to remove all incentives on behalf of the bottleneck owner to favour a particular downstream competitor. It is the only way to do that. ...[F]unctional separation, some lesser form of structural separation, does not serve the same purpose ... it never deals with that basic incentive to deal with its affiliate downstream on more favourable terms ... The only way to deal with that affiliate problem is to get rid of that affiliation.<sup>88</sup>

2.136 The hearing in Canberra on 4 March 2009 opened with a teleconference with Mr Peter McCarthy-Ward, the Director East of England, from the incumbent telco in the United Kingdom, BT (formerly known as British Telecom). Mr McCarthy-Ward provided the committee with a very open and informative account of the relevant experience of the functional separation process that BT has been undergoing for the

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85 Professor Green, Director, CEG and ATUG, *Committee Hansard*, Sydney, 3 March 2009, p 18.

86 Professor Green, Director, CEG and ATUG, *Committee Hansard*, Sydney, 3 March 2009, p. 20.

87 Professor Green, Director, CEG and ATUG, *Committee Hansard*, Sydney, 3 March 2009, p. 21.

88 Mr Ed Willett, Commissioner, ACCC, *Committee Hansard*, Sydney, 3 March 2009, p. 77.

past several years. During the discussion he made reference to the establishment of a mediator to oversee the transition process, a role that Professor Green had been advocating the previous day.

2.137 As part of the functional separation, BT created the Equality of Access Board (EAB) that was responsible for overseeing and reporting on BT's delivery of its undertakings:

This was a board committee of BT PLC board, but with a majority of non-BT members appointed in consultation with the [industry] regulator and the industry.<sup>89</sup>

2.138 Mr McCarthy-Ward commented that this mediator was still in place and 'had actually been quite a valuable asset':

If I may be completely honest, when we agreed to do it we felt it was a bit heavy handed of our regulator. ... But the practice has been that we have an internal body that is unpolluted by the sorts of conventional wisdoms that can arise within a large organisation. ... with hindsight it has been a better outcome...<sup>90</sup>

2.139 Mr McCarthy-Ward outlined several of the key difficulties experienced by BT during the separation process, particularly noting that the requirement in the undertaking to both logically and physically separate their management information systems was one of the most complicated areas of the undertakings. In perhaps a cautionary note, he commented that:

... we underestimated the complexity of this operation at the outset... logical separation systems are much more consistent with the way that modern systems architecture is developed and is a relatively painless and cheap way of achieving the necessary separation of the systems.

... it is moot whether or not the full cost of physical separation is proportionate.<sup>91</sup>

2.140 Mr McCarthy-Ward noted that the process of drafting the undertaking with which it had to comply took approximately six months, negotiating with the regulator and their competitors 'until we had crafted not only what we were willing to offer but what we knew our regulator and our industry would be willing to accept.'<sup>92</sup>

2.141 Mr Arthur Price from Axia NetMedia also made an appearance before the committee in Canberra. Mr Price again provided an external perspective of the complex issues that the NBN was attempting to resolve, commenting that Axia had provided a proposal that he believed was 'transformational in character'. Mr Price

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89 Mr Peter McCarthy-Ward, BT Director, East of England, *Committee Hansard*, Canberra, 4 March 2009, p. 3.

90 Mr McCarthy-Ward, BT, *Committee Hansard*, Canberra, 4 March 2009, p. 3.4.

91 Mr McCarthy-Ward, BT, *Committee Hansard*, Canberra, 4 March 2009, p. 5.

92 Mr McCarthy-Ward, BT, *Committee Hansard*, Canberra, 4 March 2009, p. 11.

noted that most digital economies were moving to high quality of service as opposed to purely focusing on quantity or speed of service provision. Mr Price commented that the NBN provided Australia with the opportunity to make a similar move while simultaneously addressing the problematic structure of the industry:

The industry, structured the way it is today, is full of disputes and conflicts ... I would say that in the broader context that nobody has been able to create a high-performing value chain based on a supplier competing with their customers... What competing with your customer actually does is create the ultimate conflict...<sup>93</sup>

2.142 Mr Price reiterated that to remove that conflict there is no need to force separation on the incumbent, rather:

If you can create an alternative [network] that does not have that conflict, that creates the normal value chain of a supplier not competing with their customer and leaves the incumbent to compete however they want...<sup>94</sup>

2.143 Mr Price elaborated on Axia's broadband initiatives in Alberta, Canada, in France and in Singapore, where each of the three business models, although different, was based on the same principle of 'do not compete with your customer'. Mr Price stated that situation in Australia came down to two alternatives:

You end up at that fork in the road and every regulator and policy maker does, that is, you must either change the incumbent, break them up, get them out of that conflict position, because regulation does not do it; you cannot regulate them well enough.... You either break him up or we take the other fork in the road and make him compete. ...Axia never advocates a regulatory change for the incumbent. We simply give the government an alternative that makes the incumbent compete.<sup>95</sup>

2.144 A new witness to this inquiry, Mr Dermot Cox, appeared in Canberra to provide a different perspective on the broadband issue. Mr Cox was strongly in favour of upgrading the existing HFC cable network, which he believed could 'deliver the lowest cost broadband infrastructure to major cities and towns around Australia'.<sup>96</sup> He expressed concern that 'the current policy mix seems to have caused a dire lack of investment in cable broadband over too many years' and questioned whether the

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93 Mr Arthur Price, Chairman and CEO, Axia NetMedia Corporation, *Committee Hansard*, Canberra, 4 March 2009, p. 31.

94 Mr Arthur Price, Axia NetMedia Corporation, *Committee Hansard*, Canberra, 4 March 2009, p. 32.

95 Mr Arthur Price, Axia NetMedia Corporation, *Committee Hansard*, Canberra, 4 March 2009, p. 38.

96 Mr Dermot Cox, Marketing Director, C-Cor broadband Australia Pty Ltd, *Committee Hansard*, Canberra, 4 March 2009, p. 63.

government was aware of 'how simple and cost effective it would be to make existing cable broadband networks deliver super-fast speeds'.<sup>97</sup>

2.145 Although the upgrade was clearly addressing metropolitan areas in the main, Mr Cox did explain that it would be possible to:

Modernise those [HFC] networks and save the effort and investment dollars for the people who are underserved ... Put the bucket of money there, as distinct from replacing perfectly good broadband [HFC] infrastructure.<sup>98</sup>

2.146 Mr Cox also made reference to the need for consultation with communities and local government, which he stated has been 'completely overlooked'. This was particularly in relation to the physical dimensions and locations of the nodes involved in an FTTN build, which would be not only significant in size but would also require a power supply and cooling systems. Mr Cox commented that 'I think some people will take an offence at the impact on their streetscape'<sup>99</sup> of the nodes.

2.147 By the time of the CommsDay Summit in Sydney on 31 March and 1 April 2009, there was heightened anticipation that the opening key note address by the minister would include an announcement of the winning bid. Although this was not the case, commentary and speculation on the outcome was rife among participants over those two days.

2.148 Despite the diversity of industry speakers at the summit, they were united in their view that the government should not restrict the NBN build to 98 per cent fibre, particularly not a FTTN build that was seen as a limiting technology, but rather to offer opportunities for mixed technology platforms that could optimise affordable service provisions in underserved areas throughout Australia.

2.149 The final announcement was made on 7 April 2009 by not just the minister, but by the Prime Minister Kevin Rudd, accompanied by the Treasurer, Wayne Swan, the Minister for Finance, Mr Lindsay Tanner and the Minister for Broadband, Communications and the Digital Economy, Stephen Conroy. Details of the announcement follow in chapter 3.

### **Conclusion**

2.150 The six final bidders to the RFP process responded in good faith, complying with the level of detail required by the government to qualify for further consideration and evaluation by the Panel of Experts. The committee has no doubt that the financial

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97 Mr Cox, C-Cor broadband Australia Pty Ltd, *Committee Hansard*, Canberra, 4 March 2009, pp 65-66.

98 Mr Cox, C-Cor broadband Australia Pty Ltd, *Committee Hansard*, Canberra, 4 March 2009, p. 68.

99 Mr Cox, C-Cor broadband Australia Pty Ltd, *Committee Hansard*, Canberra, 4 March 2009, p. 69.

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and staffing resources that this exercise must have consumed would have been significant for all bidders.

2.151 The RFP process has been the subject of ongoing criticism from all industry sectors from its very announcement in April 2008, with the 'probity' requirements imposed within the RFP preventing any substantial detail being released to the industry or the Australian public in general. The committee strongly urges that there be a full audit of the entire RFP process, to be conducted by the Auditor General. Although the committee welcomes the announcement on 7 May 2009 that the Auditor General will commence a preliminary review of the RFP, the committee recommends that this review must be seen to be thorough and comprehensive. Therefore the committee makes the following recommendation:

### **Recommendation 1**

**2.152 That the Auditor General conducts a full review of the RFP process, to be commenced before the end of 2009.**

2.153 The committee acknowledges the critical need for high level cross-jurisdictional coordination and collaboration during the planning, implementation and throughout the life of this nationally significant infrastructure project. Consequently, the committee also urges the government to fully explore all avenues to facilitate and ensure this coordination, particularly utilising those avenues the government already has in place, such as Infrastructure Australia.

### **Recommendation 2**

**2.154 That Infrastructure Australia be involved in the NBN process to the fullest capacity.**

