A Submission to the Senate Environment, Communications, Information Technology and the Arts References and Legislation Committees on the Inquiry into the Telstra (Transition to Full Private ownership) Bill 2005 and related bills

A Submission on the Telstra Sale Bills by Kevin L Morgan

Introduction In a telecommunications market like Australia governments cannot worship the twin gods of privatisation and competition. A choice must be made. Either the regulatory regime must be wound back to give Telstra a fair chance and allow it to meet its 'social' obligations or the government must accept a rapid deterioration in the quality and cost of national telecommunication services.

Given the regulatory decisions of the last fourteen years, and the partial privatisation of Telstra, driven by cost cutting, inflated dividends and under investment, there is an irreconcilable tension between the needs to invest in the national network and the regulations needed to keep competitors in the marketplace.

Despite this reality the introduction of these bills has set the stage set for Australia's biggest share sale, despite many unanswered questions. Those questions range from what price a Telstra share, to what will happen to the national telecommunications network, especially in rural and remote areas. These bills do not provide answers.

Despite a lengthy Senate Inquiry and extensive debate in the late 1990's and two subsequent independent inquiries into Telstra's privatisation what will happen in the longer term, especially to Telstra's rural customers and existing shareholders is unknown.

It would seem the Government isn't too bothered with such questions. The sole concern would appear to be how to realise the hoped for $30 billion from the sale. That was the concern that seemingly led the Prime Minister and other senior ministers to describe the public concerns raised by Telstra's management over recent weeks as

“disgraceful” and to their suggestions that Telstra’s management had a responsibility to ‘talk up’ the company irrespective of the realities facing the management team.

Given events of the last week and the Government’s almost indecent haste in pushing these bills through it would appear to sale is being driven by financial expediency and ideology rather than a desire for rational policy that is in the public interest.

Quite simply if the Government was genuinely seeking the claimed benefits of privatisation then they need go no further. Telstra has been behaving as a profit driven, cost conscious company for nearly a decade. Staff numbers have been halved, union power curbed and capital expenditure slashed to boost earnings and dividends and to sustain an inflated share price.

The scene has been set and regulation has forced open the market and created an illusion of choice and consumer welfare under which the full privatisation can proceed. Nevertheless new rationales are being constructed for the sale to offset the waning enthusiasm of the market for ‘T3’. This submission addresses these new rationales for privatisation and suggests that like earlier arguments for divesting the government’s stake in Telstra they fail to meet a test of public interest.

The Ownership Dilemma The suggestion that the present hybrid ownership places the government in an untenable position as regulator and owner is not a challenge in other markets. The regulator (the ACCC) is at arms length from government as is the board of Telstra. Both operate under statute and as recent events have demonstrated, both are prepared to act independently. For the Government a conflict arises only when the actions of either the regulator or Telstra impact on the expected sale price.

Hybrid ownership in Europe, where the giants Telecom France and Deutsche Telekom are still part government owned shows that public ownership is no obstacle to growth and innovation. Both have recovered from self inflicted wounds suffered during the battle for third generation mobile licences to become powerhouses not just within Europe but on the global scene.

Their success and the ability to manage the huge debts they built up four years ago proves that part public ownership need not hold a telecommunications company back. This is especially so when the ownership regime has been carefully meshed in with well planned market liberalisation.

Regulatory Bias Unlike European operators Telstra does not enjoy the luxury of operating in a rational market. It finds itself operating in the world's most highly competitive telecommunications market where regulation has been skewed not merely to encourage market entry, but to force competition irrespective of the costs and the damage being done to the national telecommunications operator and the public interest.

Consider the latest twist to regulation that flows from the pricing of Unconditioned Unbundled Local Loop. Telstra is legally obliged to offer a uniform or averaged national tariff to retail customers i.e. the same price in the bush or the city. That tariff doesn't reflect the individual cost of service.

Now it is being legally obliged to deaverage its wholesale tariff i.e. the price at which competitors can access its network. That makes Telstra even more vulnerable to cherry picking i.e the competitors get much cheaper access to Telstra's network in the city and can price accordingly to reflect these lower wholesale prices. Telstra has to stick with its uniform retail tariff.

Regulation has transferred 30% of the former monopoly's market to competitors, mostly by courtesy of Telstra's own network.. The Australian market is now saturated in both fixed and mobile services and at best Telstra is faced with flat revenues. The recently reported decline in high margin fixed network (PSTN) earnings of 6% is expected to accelerate.

Telstra has little prospect for growth has little prospects for growth other than in broadband carriage and content delivery and in this market segment Telstra finds half that its broadband customers are very low margin wholesale customers i.e. those buying Telstra's network through other vendors of broadband. Consequently by using Telstra's network at cost, competitors are enjoying 50% of the value being created in the broadband boom.

Whilst it might be deemed that Telstra ought not complain about skewed regulation and should respond competitively through more attractive offerings of content etc. it finds a somewhat over enthusiastic regulator, the Australian Consumer and Competition Commission breathing down its neck.

The ACC has foreshadowed concerns about Telstra acquiring exclusive content rights.

The Relationship with the Regulator Without overstating the difficulties of Telstra's relationship with the ACCC there is some bias in the regulator's attitude toward the dominant carrier. Hints of bias were exhibited by the ACCC's chair Graham Samuel in an interview with ABC Melbourne radio's John Faine on 2 September.

Essentially Mr Samuel suggested Telstra should stop complaining and get on with the job of competing with other carriers. He suggested that Telstra was like any other Australian company and was merely subject to the same a legal requirement that it not act anti-competitively.

At best it is a massive oversimplification of the position Telstra finds itself in compared to other major Australian companies. Significant and highly complex sections of the Trade Practices Act are telecommunications industry specific and provisions, especially on network access, bundling of services, price discounts etc. apply only to Telstra.

The question is not how well the ACCC is applying these laws but whether they are rational in the first place. The telecommunications specific sections of the act may be viewed not as governing competition, i.e. creating a level playing field but as creating market entry opportunities for others and then sustaining market entry for Telstra's competitors i.e. regulation for competition no matter how economically irrational, rather than regulating competition on the vaunted level playing field.

Mr. Samuels also exhibited some bias toward Telstra arguing that Telstra only responds to competitive pressure and wouldn't innovate otherwise. If that were the case prior to the introduction of competition in 1992, we'd have still have had wind up telephones and

an army of hundreds of thousands of telephone operators! It's a patently false assertion yet such attitudes pervade the regulatory approach taken toward Telstra. .

The Investment Dilemma Because of skewed regulation the issues that now confronts Telstra in investing and innovating cannot be avoided. When Telstra innovates and invests it creates opportunities for others. Competitors, who by and large use Telstra's network to reach customers, can only innovate with services such as high speed broadband when Telstra upgrades it core network.

The issue for Telstra, as for any dominant (former monopoly) phone company, is whether the investments needed to offer new services on its own behalf are justifiable when competitors have legal rights to access the Telstra network at marginal cost i.e. at a cost which may fail to cover Telstra's 'commercial' cost of capital. The problem for Telstra is heightened by the fact that competitors using Telstra's network then divert revenues from Telstra which are needed for network upgrades and most significantly cross subsidies to rural and remote areas.

The Challenge in Rural and Remote Areas

> "*My worry is if the government sells out of Telstra the level of service will decline. Private enterprise is focussed on profit. Can you imagine a private company wishing to maintain services in rural and outlying areas for small or no profit?"*
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> Bob Conolly (Farmer), 25th February 2005 at a telecommunications forum held by the National Party Page Centre in Wagga Wagga, NSW.

There can be little debate that the Australian telecommunications market is the most challenging in the world. Telstra's national network serves the world's most geographically demanding market. Although 80% of its 10 million customers live in or near the capital cities, 20%, some 2 million, are spread over an area larger than Europe with 80% of the continent having only 40000 customers. Unlike telephone companies in other large markets such as the USA and Canada, Telstra has never had the comfort of massive public subsidy, or co-operative and regional ownership of the telephone network in rural and remote areas.

Telstra, like its predecessor Telecom, has to support high cost and consequently loss making rural and remote customers through a web of cross subsidies which have kept telecommunications costs uniform across Australia. Despite the arcane economic theory about contestability and tendering out loss making rural areas, these customers are of absolutely no interest to competitors and will remain Telstra's sole responsibility.

Since the network monopoly ended in 1991 no competitor has made or even attempted to make major inroads into the bush. Although there have been several short lived attempts to build alternative infrastructure in major provincial cities the major competitors to Telstra have stayed out of the country. With full liberalisation of the market in 1996 competitors have been free to use any technology they might chose but none have built a business case for market entry in the bush .

The behaviour of Telstra's competitors is completely rational. Why would they build infrastructure to enter loss making markets. The companies such as OPTUS, Primus an AAPT only really offer resale of the Telstra fixed network outside the capital cities although both Optus and Vodaphone have built digital mobile networks that cover about 8% of the Australian land mass. These networks replicate the digital network built by Telstra but fail to match the coverage of the Telstra analogue network which was closed as a condition for Vodaphone's entry to the market. .

The question is why would a competitor seek to enter enter the rural and remote areas when the gove4rnemt's own conservative estimate of the cross subsidy to loss making rural areas is $230 million a year. That figure is contested by Telstra who maintain the cross subsidy is in excess of $650 million a year a figure confirmed by Bell Labs research .

The Government's cross subsidy or loss on rural services is estimated using the contentious methodology of avoidable cost. In simple terms it means what would Telstra save save if it no longer provided loss making services The estimate is essentially the amount it costs Telstra to keep the loss making rural network running. It does not include upgrading, new investment etc.

Telstra's competitors argue the figure is lower than $230 million and suggest there are benefits that Telstra gains from its rural monopoly which haven't been quantified. At best this is disingenuous.

Given the current levels of subsidy needed to simply keep a Plain Old Telephone Service going what good will $100 million a year from the $2 billion investment fund do even if supplemented over the next four to five years with the government's $1 billion contribution? It is a drop in the ocean in the world of telecommunications investment where fibre optic to the home in Australia could cost $40 billon plus.

In the mid 1980's Telstra's predecessor Telecom spent $800 million on upgrading the remaining 40,000 rural and remote services to STD automatic standard. Unfortunately you don't get a great deal for a billion dollars in the high tech., capital intensive telecommunications industry.

The reality is Telstra does not hold a rural monopoly. Any competitor has the right to instal infrastructure and compete anywhere in Australia if they believe they can make money from entering the rural and remote area market. The fact that none have chosen to do so underlines the fact that providing rural service is a costly, loss making business.

The National party and its coalition partners have chosen to deny this fact. To the Page Centre, the National Party's think tank, the problem in the bush is Telstra rather than the cost structure of serving vast distances and sparse population densities.

Shortly before the release of the Page Centre report in March 2005, the then Leader of the National Party, the former Deputy Prime Minister John Anderson maintained that the answer to any shortfall in services in the bush was more competition.

Later that month the Page Centre went further to imply that Telstra was in itself an obstacle to competition. The report argued that if Telstra were sold part of the proceeds should be used by the Government to build either a rural fibre optic network or a broadband radio network in the bush. The report suggested that a fibre optic network could be built for $7 billion and a radio network for even less.

Once the network whether radio or fibre optic was established Telstra would wind up its existing copper based phone network in the bush and become one of a number of competitors using the new infrastructure which was government owned to deliver service.

Although it seemed to be a rather self defeating policy the report ignored the fact that they were merely recommending replacing one publicly owned network with another.

Clearly if competition is the answer in the bush then rural customers will have to await the arrival of the Mother Therese telephone company - someone willing to lose hundreds of millions of dollars a year competing with Telstra.

Sadly losing money isn't popular with shareholders and there's the rub for the National Party. Shareholders in a fully privatised Telstra will expect the board to maximise profits on their behalf and faced with intense, contrived competition in and between the capital cities, a rational Telstra board would have to turn to loss making rural services for cost savings and consequently sustained profits.

A simple commercial truth must be acknowledged. **Regulation cannot protect rural consumers if Telstra does not have the money for loss making rural services**

Obviously competition isn't a realistic option to the problems of the bush under full privatisation. Consequently an apparent answer has been found to a privatisation induced deterioration in rural telecommunication services through ' on budget subsidies' and an investment fund. But despite the fine detail of these bills and their laudable intent arguing with surplus obsessed politicians who control Treasury isn't a good way to fund vital infrastructure.

The costs of the rural network are of course largely sunk in investments made in the 1970's and 1980's when Telecom, driven by an earlier ethos of public service, developed low cost radio systems for rural service, installed digital exchanges and ploughed in copper cable to replace open wire systems strung down telegraph poles.

Unfortunately those investments are now ageing. They are not competent to carry the traffic of the Information Age, most notably high speed Internet access.

The Need For Investment Nor is the problem of an ageing network confined to the bush. In many urban and regional areas the network needs urgent upgrading. Despite the hype about an acceleration in broadband take up in Australia, especially through ADSL technologies, the fact is that true broadband is available to few Australians and digital access to the Internet is limited in speed by the condition of Telstra's copper network.

But the moderate broadband speeds now common in urban areas of between 126 – 250 k. bits per second are a dream for most of Telstra's rural customers users. They are stuck with Telstra and no private telecommunications company could pick up the tab needed to deliver high speed Internet access in the bush.

This has been tacitly admitted by the government's most recent inquiry, the Estens Inquiry into the adequacy of regional and remote telephone services. In an attempt to determine whether these services met the Government's test of 'being up to scratch' before a full sale could proceed, the inquiry found that rural and emote services could not be mandated at the same level of quality and speed as urban services .

No Hope for the Future Whilst Estens found fault rates, service times and the quality of standard telephone service were comparable in the bush to urban areas it noted that in reality many rural users could not hope for better than 19.6 kits per second for Internet access, a standard which they felt should be required by regulation.

This means many rural users, who now find it difficult to do more than send simple emails, have no prospects of ever accessing the image rich content of the Internet at reasonable cost. In effect a real and discernible gap in the price and capability of telecommunications services between the bush and urban areas is not only opening up but will become entrenched.

Quite what the cost of providing higher speed data and Internet access in the bush would be is an open ticket. It could readily exceed the $20 billion plus needed to push fibre optic to homes in urban areas so city dwellers can get true broadband access.

Like it or not no privately owned company can make such investments. They are investment programmes of national significance which only governments can make.

The government's answer to this investment challenge is to ignore it. Instead of addressing these issues the government prefers rhetoric about 'future proofing the network' which means little more than guaranteeing today's services and service standards.

But even this is problematic. Telstra cannot maintain the Government's hoped for share price and also invest especially in rural areas, even to maintain current service levels. This is particularly so under the current regulatory regime which has massive disincentives for Telstra to invest when it has to make its network available to competitors at little more than cost.

Either the network must be upgraded and Telstra's earnings and share price fall to more realistic levels or rural and remote customers will suffer real and consistent declines in service quality and they will never get access to broadband other than through high cost satellite services or limited geographic access through CDMA for which users must pay a premium.

Paying for Competition and the Share Price Despite these obvious problems Telstra has generated record profits. These have been achieved by savage cost cutting and winding back investment to levels 20% below those of a decade ago and by living off the 'fat' accumulated in the last decade of full public ownership.

Despite a popular perception that Telstra's predecessor was a bloated overstaffed public sector monopoly whatever its sins it engaged in sound engineering practices and built a high quality and resiliant national network. That network has stood it in good stead over many years but as noted it is now ageing and needs upgrading.

In the years before competition prices were falling and Australia stood in the middle of the OECD rankings for cost of service. As noted it has slumped to the bottom of the OECD league table only marginally above OECD new comers such as the Slovak Republic and Poland

Clearly Telstra's customers have contributed significantly to these large profits. With the myth that competition was looking after the consumer's interests the telecommunications companies, including Telstra have not been obliged to pass on the full cost savings from technological change.

It is a received yet unfounded wisdom amongst regulators and policy makers that competition has benefited consumers. Yet since the early 1990's Australia's telecommunications specific competition regime has done nothing to improve Australia's relative performance in terms of telecommunications costs compared to other OECD countries - we've gone backwards.

In 1992 in terms of the cost of a standard basket of residential phone services Australia ranked 18th. down the OECD table. In 2004 Australia ranked 24th. Similarly for business phone costs Australia ranked 16th. in 1992 and now ranks 24th. (Source OECD Communications Outlook 1993 and 2005)

Consumers have paid dearly for the supposed choice competition offers them. Had the gains of technology been passed on to consumers rather than squandered on duplicate investment or had regulation focused on actual behaviour in the market place rather than creating market entry opportunities consumers would be paying markedly less for telecommunications services in Australia than they are today.

Telstra is Overvalued Yet despite these domestic realties and despite Telstra's failure to achieve growth offshore with $3 billion being lost in its ill advised Hong Kong investments, Telstra's share price remains relatively buoyant and it is touted as a strong performer compared to its international peers.

Although the share price has slumped from a high of $8.25 shortly after the sale of the second tranche of shares in 1999 Telstra shares had, until recent weeks, settled down to trade comfortably at nearly $5 a share.

That share price makes Telstra one of the world's most valuable telecommunications companies and propelled it to a stellar position globally. In 2002 Telstra ranked 116th.in terms of market capitalisation amongst the Financial Times Global Five Hundred Companies ,ahead of giants such as France Telecom, a company three times its size.

Comparisons with other telecommunication companies are fraught with difficulties because much has changed globally in recent years but one thing is clear, if the sale realises the hoped for $30 billion it will confirm Telstra as being relatively far more valuable than the BT group (formerly British Telecom), France Telecom or Deutsche Telekom all companies more than 2 to 4 times its size in term of customers and revenues.

It could be argued that Telstra's exalted position is justified compared to these European operators as it does not have the mountains of debt that only a few years ago threatened the very existence of many of its larger peers.

Telstra's board point proudly to the fact that it only owes $6 billion compared to the $100 billion plus that encumbers the balance sheets of international operators such as German and France Telecom. Indebtedness has risen though because of the need to inflate the share price through payment of dividends from new borrowings.

The fact that Telstra escaped a similar level of indebtedness to its peers owes more to good luck than to management acumen. Fortunately for Telstra the bubble burst on third generation licence fees before the Australian government auctioned wireless spectrum three years ago. Had the Australian government achieved its hoped for $20 billon plus for third generation mobile licences, Telstra too would be massively indebted.

But crippling though those debts have been for the European giants, long term prospects for growth and the use of debt to acquire valuable assets, such as France Telecom's

purchase of the global mobile operator Orange, means that growth prospects outweigh short term concerns in the European market.

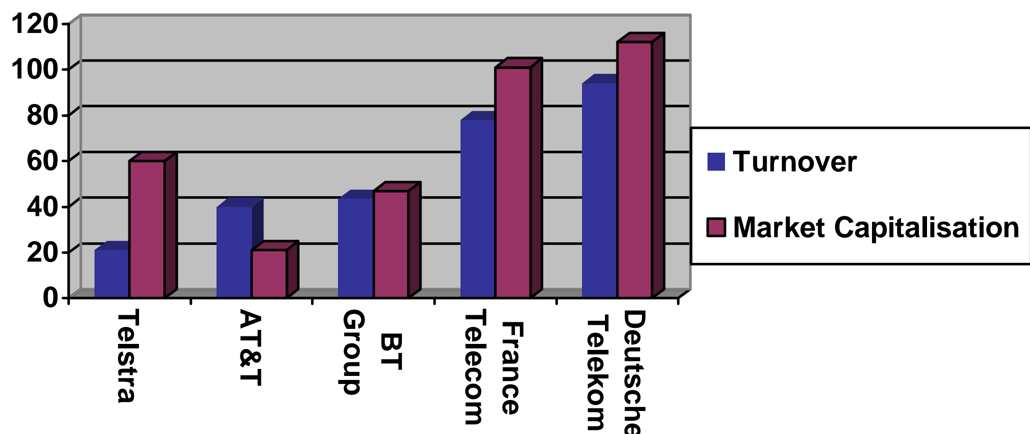
The European companies sit at the heart of the ever expanding European Community market of 300 million plus. They are not restricted to a small national market that is massively skewed against them by regulation and they have already secured significant and profitable international growth.

By any comparison it would seem that Telstra is massively overvalued and the inflated share price cannot be sustained under full privatisation. With half Telstra's shares locked away there has effectively been a false market, especially amongst institutional investors. Scarcity has provided a floor for the Telstra share price with the floor price being maintained by measures such as the $1.7 billion share buyback.

One is entitled to ask what will happen to the sghare price once the contrived scarity of shares ends?

Many of the institutions are now more realistic in their assessment of Telstra, viewing it as a utility company rather than a growth prospect and given recent events they will not be willing to pay the Government's asking price of $5.25 plus.

Turnover and Market Capitalisation 2004
(Billions A$)



Retailer investors will also be understandably wary of T3 as many are still carrying losses from the Telstra 'Two' sale. The average investor who each bought 700 shares in the second round are carrying a loss of $2000 and as the Sunday Age reported in January 2005 the return from investing in the earlier Telstra floats in 1997 and 1999 is now 9.9% compared to a rise in the All Ordinaries index of 66% since 1997. Those losses have been heightened by the rapid decline to $4.30 during the first week of September.

In a rising market there are more attractive investments and Telstra will have to fight for shareholders interest. The army of advisers and bankers who creamed $429 million in fees and commissions in the first two rounds of the Telstra sale may have to work for their money and may even face a real risk in underwriting the issue. This has been acknowledged with potential advisers to the float arguing that Telstra may have to engage in a $10 billion 'buy back' of government shares to prop up the price.

An alternative to such a buyback, which Telstra can ill afford given the demands for new capital investment, is to warehouse the shares in the Future Fund. Whatever merits the Future Fund might have it is clear that loading it with Telstra shares would limit the funds growth given the relatively poor performance of Telstra shares aginst the stock market generally.

It is also obvious that the challenge of 'off loading' the 51% stake has become more become more difficult as the debate has intensified and as the extent of the challenges facing Telstra have become more widely known to the market especially the difficulties that confront Telstra in its ongoing responsibility to service rural and remote customers.

The answer to the problems of rural network investment canvassed by the Estens Inquiry and now embodied in these bills is an infrastructure fund that would build on earlier programs such as the $1 billion Networking the Nation programme which was funded from earlier sale proceeds.

On Budget and Of Target Programmes such as Networking the Nation and other initiatives funded from previous Telstra sale proceeds have been marked by high administrative costs and a difficulty in finding worthwhile and sustainable projects. The

Auditor General found that it was difficult to determine whether these programmes were really meeting the Government's broader policy objectives.

It is clear that dishing out public money to community groups and local government is not an efficient way in which to develop a national telecommunications network.

Given this past experience with 'investment' funds and on-budget subsidies these measures cannot secure Australia's telecommunications future. **If the full sale proceeds, future funding of the rural network will be marked by the vagaries of 'on- budget funding', turning the clock back to pre 1976 when the Post Master's General's Department administered the network.**

Has The Time for the Sale Passed? Expediency and political ambition preclude any consideration of these complex questions. But they have also led the government to ignore a far simpler question. Has the time for the full privatisation of Telstra passed unless the massive regulatory bias against Telstra is relaxed?

That regulatory bias has forced Telstra into a corner from which it can only escape and meet the national need for advanced telecommunications services when its monopoly is largely restored. Without a return to a more rational market structure, which recognises the realities of natural monopoly in the telecommunications industry, a full sale can only lead to a downward spiral for Telstra's investors and customers.

But in today's climate, with competition still dominant on the policy agenda, it is highly unlikely that regulation will be wound back. Telstra will be sold in market that offers it no scope for growth and under a regulatory structure that threatens its very survival.

The question must also be asked whether Telstra has the team in place to meet the challenge. Recent events would suggest that the simple riding instructions of 'get the Government's final 51% away at a price that will not alienate the 700000 'mom and dad' investors who bought shares in the second round of Telstra's privatisation' are beyond the new management team.

Already the share price has plunged because unlike the previous management team Mr. Trujillo and his colleagues have told a few uncomfortable truths. The newly appointed CEO and the Board will need all their skills to balance the conflicting pressures in the sale process which they have publicly exposed.

Events of recent weeks can only serve to make many in rural areas, who were already nervous, even more nervous about the sale. Clearly many remain concerned about the sale, fearing a rapid decline in rural telecommunications investment and service standards. Shareholders, and especially the so called 'moms and dads' who paid $7.40 in Telstra 2 are dismayed at recent events. They had hoped to see the share price rise beyond the Government $5.25 - $5.40 benchmark for the float. Employees, fearing job cuts as Trujillo chases much vaunted cost savings, will also want some assurance.

What can the new management team offer which will meet these conflicting expectations? Mr Trujillo 's time US West, which served the 14 mountain states of the North West of the United States suggested, at least to the Telstra Chairman Mr McGauchie, that he had the credentials for the task.

Specifically it was claimed that Mr Trujillo s had unique experience in serving rural and remote customers. On announcing Mr. Trujillo's appointment Mr. McGaughie said,

> *"His time with US West/Mountain Bell covering diverse geographies such as Colorado, Kansas, New Mexico and Arizona means he has experience running businesses in geographies similar to Australia,"*

But whilst US West's service area does include remote communities and farms much of the responsibility for serving high cost customers in the North West fell on dozens of independent telephone companies that are typical of service in the rural USA. .

Nor can Telstra customers take much comfort from US West's tag as US Worst. Although Mr Trujillo has shrugged off his former employer's tag for poor service and whilst he is credited with significant improvements in US West service quality in the second half of the 1990's, the fact remains that US West suffered far more consumer complaints than other large phone companies in the North Western area such as GTE..

Despite claims that US West made massive gains in service quality under Trujillo the problems remained so severe in 1999 that the state regulator in Colorado took the extraordinary step of issuing a notice to consumers explaining why they couldn't get dial tone i.e. why they simply couldn't always make a call. The Public Utilities Commission stated that the problem lay in underinvestment, a criticism of Trujillo's time at US West that was mirrored in a class action taken by customers in the 14 states the company served.

In US West's home state, Colorado, the complaint accused the company of providing "fraudulent" service and the lawsuit accused US West of:

> *"Deliberately not telling customers of service delays, assigning higher service priorities to wealthier neighborhoods and diverting money that should have been used for serving its phone customers to instead bolster its newer product lines. "*

In October 2000 US West's successor, Qwest, although not admitting liability agreed to a settlement offering $36 million to the 244,000 customers who were affected by poor service over the previous seven years.

Those complaints take some of the gloss of much praised initiatives in rolling out high speed broadband services because it would seem this new investment was at the expense of basic network investment in the rapidly growing mountain states area. The rate of basic investment was so slow that many US West customers were still being served by old technology analogue telephone exchanges, nearly a decade after Telstra had completed full digitalisation of its exchange network.

Indeed under Mr Trujillo it would seem that rather than nurture and develop its basic customer network and give real meaning to Trujillo's mantra of 'customer intimacy', US West set out to divorce large numbers of high cost rural customers In June 1999 it struck a US$ 1.65 billion deal to sell 540,000 subscriber lines to the Citizens telephone company of Conneticut. This followed a 1995 sale of 45 rural exchanges to Century Tel. The Citizen deal fell through two years later after Trujillo left US West when the Citizen

after acquiring an initial 17000 lines complained that customer revenues did not match US West's earlier estimates.

Despite that mixed record, on announcing Mr. Trujillo's appointment,Telstra's Chairman Donald McCaughie said:

> "*Mr. Trujillo has successfully led a number of major cultural and business change programs. We believe Telstra will similarly benefit from his pragmatic innovation, strategic and tactical thinking and outstanding implementation."*

Perhaps Mr McGauchie should have looked a little deeper to see where Mr, Trujillo's " pragmatic innovation, strategic and tactical thinking and outstanding implementation' could lead!

On the 18 June respected economic commentator Terry McCrann asked whether Trujillo had been appointed because he offered a promise of growth that would lead to a higher share price. Specifically McCrann asked::

> *"Does the new Telstra chief executive officer Solomon Trujilllo believe he can get the share price back to the $7.40 paid by retail investors in T2? Does he intend to try.?....if so it spells disaster for Telstra and it would result in small investors in the third tranche being burnt "every bit as badly as they were in T 2".*

Mcrann noted that Telstra is, if not the world's most profitable telephone company, amongst the top three and it earns:

> *"a staggering 50c of operating profit on every dollar of revenue .. to suggest it could lift its margin to 75c in the dollar is simply ludicrous. "*

As Terry McCrann points out Telstra could get its share price up;

> "*by for example sacking half its workforce (which) would destroy its business and its existing profits."*

But Mr. Trujillo comes to Telstra after a decade of cost cutting in which Telstra's investment progamme has fallen by 40% in real terms and the workforce has been halved whilst it has lost 30% market share under regulatory rules stacked against it. Trujillo may believe he can get growth from some regulatory relief and he has certainly made the right noises about the nonsense of breaking Telstra up, but the Australian regulatory regime is far different from the US and he has obviously hit a brick wall in Canberra.

In the late 1990's Trujillo's US West stonewalled competitors with fourteen law suits that limited interconnection and access to US West's network. The Australian Competition and Consumer Commission are not responding kindly to such an approach. And the reality is the the regulatory regime faced by Telstra is far more complex and more onerous than any regulation State or Federal confronting a Baby Bell.

The question must be asked. Is the Telstra management team up to the task and does the government have a duty of care not as a shareholder but as national policy maker to now intervene on behalf of telecommunications users in Australia?

A need for Leadership Despite record profits Telstra has performed poorly on many fronts over recent years. There is a clear need for leadership and Telstra cannot assume that leadership role whilst its management is driven by the need to appease the share market's unrealistic expectations and the need to reach a share price that will meet the Government's preconditions for full privatisation.

Such has been the preoccupation of the senior management group with cost cutting and driving up the share price over recent years that it has clutched at straws in the hope it can stimulate growth. At the height of the late 1990's Dot Com boom partnerships and equity plays were formed and dissolved at dizzying speed. None delivered real growth and the largest of all, the joint venture with Hong Kong based Pacific Century Cyber Works (PCCW) has resulted in over $3 billion being written off leaving Telstra holding a modestly profitable mobile network in Hong Kong formerly owned by PCCW.

This specific venture demonstrates the critical need for the Government to provide leadership and direction for the Telstra Board and its senior management team. At best the Government ought protect Telstra from the naivety which saw it rescue PCCW's

owner Richard Li from the embarrassment of competing with his father Li Ka Shing who owns Hong Kong's largest mobile network operator Hutchison . Such errors suggest more than poor judgement. They suggest a loss of direction by Telstra.

That sense of direction must be found if Australia is to have a future in the Information Age. Privatisation under the current regulatory settings and with the current management team does not offer the scope for such leadership. Only governments can offer the necessary leadership.

Conclusion The crisis is more acute than commonly understood. Given this crisis Telstra should not be sold and the federal government and private investors, must accept a lower rate of return that is commensurate with Telstra's standing as a mature utility company that still needs to invest. Telstra's ability to reinvest can be secured by refocussing regulation from competition at all costs to rate of return regulation that ensures that Telstra gets a fair return on its investment.

Ultimately it will be Telstra's standing as a mature utility company generating regulated rates of return that will lead to resolution of the ownership issue. Acceptance of a regulated rate of return will see Telstra's share price fall to a more realistic and appropriate level. For Telstra that should be well below three dollars. With a realistic share price government could gradually buy back the 49%. held by the public and by institutions. Telstra bonds could be issued to part fund a buyback and Telstra's balance sheet would certainly be able to carry higher level of debt especially if the regulatory environment was favourable and secure.

Government cannot ignore the crisis that threatens to engulf Telstra and it must address the regulatory settings as a precursor to resolving the future ownership of the national network.