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SENATE

ENVIRONMENT, COMMUNICATIONS, INFORMATION TECHNOLOGY AND THE ARTS REFERENCES COMMITTEE

Reference: Performance of the Australian telecommunications regulatory regime

WEDNESDAY, 4 MAY 2005

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SENATE

ENVIRONMENT, COMMUNICATIONS, INFORMATION TECHNOLOGY AND THE ARTS REFERENCES COMMITTEE

Wednesday, 4 May 2005

Members: Senator Cherry *(Chair)*, Senators Mark Bishop, Conroy, Lundy, Tchen and Troeth

Participating members: Senators Abetz, Allison, Bartlett, Bolkus, Boswell, Brown, Buckland, George Campbell, Carr, Chapman, Colbeck, Coonan, Crossin, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Harradine, Humphries, Knowles, Ludwig, Mason, McGauran, Nettle, O'Brien, Payne, Robert Ray and Watson

Senators in attendance: Senators Cherry, Conroy and Troeth

Terms of reference for the inquiry:

To inquire into and report on:

(1) Whether the current telecommunications regulatory regime promotes competition, encourages investment in the sector and protects consumers to the fullest extent practicable, with particular reference to:

(a) whether Part XIB of the Trade Practices Act 1974 deals effectively with instances of the abuse of market power by participants in the Australian Telecommunications sector, and, if not, the implications of any inadequacy for participants, consumers and the competitive process;

(b) whether Part XIC of the Trade Practices Act 1974 allows access providers to receive a sufficient return on investment and access seekers to obtain commercially viable access to declared services in practice, and whether there are any flaws in the operation of this regime;

(c) whether there are any structural issues in the Australian telecommunications sector inhibiting the effectiveness of the current regulatory regime;

(d) whether consumer protection safeguards in the current regime provide effective and comprehensive protection for users of services;

(e) whether regulators of the Australian telecommunications sector are currently provided with the powers and resources required in order to perform their role in the regulatory regime;

(f) the impact that the potential privatisation of Telstra would have on the effectiveness of the current regulatory regime;

(g) whether the Universal Service Obligation (USO) is effectively ensuring that all Australians have access to reasonable telecommunications services and, in particular, whether the USO needs to be amended in order to ensure that all Australians receive access to adequate telecommunications services reflective of changes in technology requirements;

(h) whether the current regulatory environment provides participants with adequate certainty to promote investment, most particularly in infrastructure such as optical fibre cable networks;

(i) whether the current regulatory regime promotes the emergence of innovative technologies;

(j) whether it is possible to achieve the objectives of the current regulatory regime in a way that does not require the scale and scope of regulation currently present in the sector; and

(k) whether there are any other changes that could be made to the current regulatory regime in order to better promote competition, encourage investment or protect consumers.

(2) That the committee make recommendations for legislative amendments to rectify any weaknesses in the current regulatory regime identified by the committee's inquiry.

WITNESSES

Committee met at 9.25 a.m.

GERRAND, Professor Peter Hamilton, Private capacity

CHAIR—I declare open this public hearing of the Senate Environment, Communications, Information Technology and the Arts References Committee in its inquiry into the telecommunications regulatory regime, and I welcome everyone here today. The committee's inquiry is into whether the current telecommunications regulatory regime promotes competition, encourages investment in the sector and protects consumers to the fullest extent practicable. The committee has received 39 submissions from organisations and individuals interested in the inquiry. This is the sixth day of hearings. We have already had hearings in Canberra, Sydney, Dubbo, Townsville and Perth. The reporting date is 23 June.

For the benefit of all our witnesses, I will point out that the committee prefers all evidence to be given in public. But should you, at any stage, wish to give your evidence, part of your evidence or answers to specific questions in private, you may ask to do so and we will consider your request. I welcome Professor Peter Gerrand. Thank you for your time today; it is much appreciated by the committee. You are reminded that evidence given to the committee is protected by parliamentary privilege, and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I invite you to make an opening statement before we move to questions.

Prof. Gerrand—I have not provided a new submission to this committee. I provided a submission, and was a witness back in February, to your previous inquiry into the provisions of the ACMA Bill. I was quite pleased that the committee chose to pick up some of my input to that and even agree with me at times on some of the submission, which was great. The issues that I raised there are still relevant to at least three of your terms of reference for this particular inquiry, so I will speak to those.

I would like to begin by making the general statement that it is just as important to Australia to have very good national telecommunications infrastructure as it is to have very good infrastructure for roads and for rail. Yet there is a mindset in Australia, perhaps more in the business pages of newspapers than elsewhere, that we can rely on the market alone to keep rolling out good national telecommunications infrastructure. That is no more likely than it is that you can rely on the market to keep rolling out good national roads or a good national rail system. Private sector investment in these three areas, including telecommunications, will only go where there is a very strong expectation of high traffic, as can be seen in the actual investment patterns of competitors to Telstra to date.

I want to first talk about reference 1(c):

… whether there are any structural issues in the Australian telecommunications sector inhibiting the effectiveness of the current regulatory regime.

In my previous submission—which was quoted in the report *A lost opportunity?*—I pointed out there are three areas where the market and a good competition regime alone cannot suffice to meet Australians' telecommunications needs. The first point is that there is not regional equity in the accessibility and affordability of advanced services. That has been fairly well-recognised

over the years, at least as far as the regions that are classified as 'rural and remote' Australia are concerned. What is not so widely realised is that Australia's geographically largest cities—Sydney, Melbourne and Brisbane—are so extensive. In the case of Melbourne, it has a 50-kilometre radius out from where we are sitting today. This means that you will get so-called black spots or telecommunications deficiencies not just now, but with every new roll-out of advanced telecommunications systems.

The second area where the market alone cannot suffice is in community equity of basic services within a region. Again, I want to raise the important issue of Cranbourne in south-east Melbourne. It is a point that was not taken up in the *A lost opportunity?* report, but there seems a better opportunity, with your terms of reference, to raise it here. The third point is that the market alone cannot provide the necessary roll-out in national equity in terms of penetration of advanced infrastructure relative to our international competitors.

All of these require levels of either cross-subsidy or public sector investment. Unfortunately, in telecommunications we have lost the natural cross-subsidy mechanism which was active in Australia from Federation not only to the end of the monopoly in 1991 but effectively through to 1997 when Telstra was still a de facto monopoly. Through those 97 years, the national carrier, under its different names—PMG, Telecom Australia or Telstra—was able to every year reinvest up to perhaps 80 per cent of the surplus of its profits from the well-established and more highly populated areas in Australia to roll out infrastructure into new areas. That mechanism has entirely gone.

The pressures on Telstra are such that, as you know, it is delivering 80 per cent of its profit each year to its shareholders. The shareholders benefit, but the customers do not. The government at the moment gets somewhat more than $2 billion per year in dividends from Telstra. There is a potential mechanism there for reinvestment of that $2 billion a year back into telecommunications. I do not see it happening at the moment. It would be possible to use the money from the sale of the final 51 per cent of Telstra as part of a fund and to earmark that fund for continual reinvestment in telecommunications. Unless that happens, Australia has lost that natural mechanism for reinvestment in very important national telecommunications infrastructure.

I now raise the issue of community equity and take up the case of Cranbourne. The boundaries which affect the *White Pages* directory areas were effectively frozen with the 1991 legislation, because every subsequent Telecommunications Act keeps using those same boundaries. Also, the charging zones, which affect the scope and range of local calls, were effectively frozen in the 1991 legislation. I do not have to tell you that the planning boundaries of Melbourne and Sydney have both been moved since that period.

If you travel 50 kilometres south-east from here, you come to the city of Frankston. Travelling along the Nepean Highway, there is unbroken suburbia in Melbourne all the way out to Frankston. The planning boundary for Greater Melbourne is set by the state government. It meets the bay just the other side of Frankston. As you travel east from there, you come around the other side of Cranbourne and Narre Warren.

The good citizens of both Frankston and Narre Warren are included in the Melbourne *White Pages*. It is very important for their small businesses to get that visibility in the directory of

government and business, and also important at the convenience level for residents to be included in the *White Pages*. They have every right to believe that they are citizens of Melbourne. That same facility does not apply to the citizens of Cranbourne, who are no further out from here than the citizens of Frankston and who are also included in the boundary of Greater Melbourne.

At the economic level, the citizens of Cranbourne are also penalised. There are close to 40,000 people living there. Cranbourne and Narre Warren are the two fastest-growing postcodes in the state of Victoria, so the situation will get worse in terms of the number of people affected unless the parliament does something to rectify this anomaly. If you live in Cranbourne and want to make a phone call through to the centre of Melbourne or the western suburbs, you cannot do that as a local call at 22c. The best that Telstra can provide is the wide area call, capped at 25c, which means that every single telephone call into central and western Melbourne has an extra 3c penalty, which is about a 14 per cent penalty for living in Cranbourne.

This is a structural problem. I know that there have been numerous representations from the city of Casey, initially to Telstra. Finally Telstra provided written advice that it could not make the changes without breaching relevant legislation. I urge this committee in your report to take up this issue and perhaps also look at a similar situation in the city of Penrith in western Sydney and ensure that, in improving the regulatory regime for telecommunications, you include a mechanism to periodically realign the telecommunications boundaries—both charging zones and directory areas—with the realities of the planning boundaries for our major cities. I repeat that there is no way in which the market will fix this problem.

The second term of reference I want to comment on is 1(f):

... the impact that the potential privatisation of Telstra would have on the effectiveness of the current regulatory regime ...

In my previous submission—and taken up in the report *A lost opportunity?*—I made comments that Telstra privatised in its current form will be far too powerful to be able to be regulated effectively. It is already too powerful to be regulated effectively. The whole industry knows that. We can talk about the impact of providing operational separation to try to get at this problem. At least at the moment the government's majority ownership provides some constraint on the extent to which Telstra will lobby to look after its legitimate business interests. Once that constraint is removed, and particularly if Telstra is then free to improve its business synergies by buying first into a newspaper chain, which is pretty logical, and—only if parliament relaxes the rules for cross-media ownership—buying a television network as well, with the extra media at its disposal it will be the most powerful lobbying organisation in Australia. You do need to be aware of that looking forward.

The proposals which were floated at different stages within the Telstra board to buy Fairfax, to have a merger with Fairfax or to buy a TV channel make perfect business sense, you would have to say, from its point of view. The reality is that in telecommunications in a developed country like Australia, one by one the older products like basic telephone calls reach saturation point and the organisation has to keep looking for new areas of business in which to make a profit. It makes very good sense not only to get the synergies of all the extra content and advertising that you get through a newspaper chain to flow through into a Sensis kind of business for online

databases but also to make this enlarged valuable content available through your mobile phone or in the future through screens on your normal fixed telephone.

The last term of reference I want to comment on is reference 1(g):

... whether the Universal Service Obligation (USO) is effectively ensuring that all Australians have access to reasonable telecommunications services and, in particular, whether the USO needs to be amended in order to ensure that all Australians receive access to adequate telecommunications services reflective of changes in technology requirements ...

I would say that one weakness in the USO regime is that it is hinged on competitive bid of retail services into rural and remote Australia. Because Telstra has got in effect non-transparent boundaries between its retail and wholesale infrastructure business, it always has a tremendous advantage over other companies in bidding for those services. I encourage the committee to look at the potential for refocusing the USO on competitive bids for infrastructure roll-out. Once you have the infrastructure in place, you can have no shortage of retail competition building on that infrastructure to provide services into areas which are neglected at the moment.

When you travel around Australia—and I am sure this committee travels more than most—you become aware of deficiencies in mobile cover. At the moment the agreement is to roll out mobile coverage to at least cover the major highways—but not all A-class roads, and certainly not B-class or C-class roads. There is an agreement to provide mobile coverage to populations of 500 or more. There are a lot of townships with populations of 200 to 500 in the state of Victoria, let alone the rest of Australia.

I would say that there could be much more value obtained through federal government expenditure with the USO and actually pitching it to infrastructure roll-out at the wholesale level and then forcing the infrastructure provider to make that infrastructure available to all legitimate retail providers of telecommunications services. I will be very happy to discuss any points you want to raise.

CHAIR—I wanted to ask a question about Telstra's reinvestment. You make a very interesting point about the dividend payout figures. I think you said it was 80 per cent now. Would the old Telecom have had a similar payout figure or a much lower payout figure and reinvestment?

Prof. Gerrand—In those days it was a fully government owned business enterprise. The terminology would have been 'surpluses' rather than 'profits'. There would have been decisions made by the federal government as to how much of the surplus would be repaid each year to Canberra. From my experience as a planning engineer in the 1980s, a reinvestment of 70 to 80 per cent of the annual surplus back into the network would have been typical.

CHAIR—I have done a little bit of study, as has this committee with its infrastructure report, on the level of capital investment by Telstra, which does appear to have been in long-term decline. I am just wondering what your thoughts would be about that payout figure if Telstra were further privatised. I would have thought that you cannot get much higher than a payout figure of 80 per cent.

Prof. Gerrand—I do not think you can, because, even though the financial institutions in the share market are almost totally focused on short-term returns, like the next three months, they are also aware that if there is not some investment going on to provide competitive services at

least 18 months to two years down the track then the investment is not worth hanging onto for much more than 12 months. I agree with you. I think 80 per cent of handout of profits to shareholders, leaving 20 per cent only to reinvest, is probably the safe maximum.

CHAIR—Just thinking aloud: from the government's point of view, I have never really thought that 50 per cent of 80 per cent is, as you say, around $2 billion coming back to government. That would almost suggest that the government is actually better off, in a budget sense, with 50 per cent of 80 per cent than it was with 100 per cent of 20 per cent, prior to privatisation.

Prof. Gerrand—Many economists have pointed that out.

CHAIR—That is quite interesting.

Senator CONROY—We hear a lot of commentary to the effect that structural separation is technically impossible. We have Telstra appearing before us later today. What would you say to them if they said: 'It's not possible. We can't physically separate our network'?

Prof. Gerrand—Of course it is not technically impossible. Modern technology is just so flexible that you can separate out the different functionalities, the different products and services, of an organisation like Telstra any way you like. The real issue is the cost-effectiveness of doing so—does it become prohibitively costly? It is, first, very important to recognise that it is technically possible. Is it going to be cost-effective in meeting the public policy aims of the whole exercise? Some of you may be aware that last year I wrote a long paper, about 15 pages, in the *Telecommunications Journal of Australia*, where I went through the various submissions to the short-lived inquiry into structural separation of January-February 2003 and debunked a lot of the arguments of why it was either technically impossible or too costly to structurally separate Telstra. Not surprisingly, the estimates provided by the incumbent for the cost were very conservative indeed. In my article I indicated you could probably achieve the structural separation at probably about a quarter of the claimed costs, or better.

I notice that in the last few months, on the one hand, the Page Research Centre has quoted some construction engineers as estimating the cost of rolling out optical fibre to all customers around Australia as being about $7 billion, and, on the other hand, Telstra has indicated it is about $30 billion. There is good reason for thinking that the construction engineers are perhaps underestimating the cost and that Telstra is overestimating the cost. I think a safer estimate would be about the $20 billion figure, which basically would be achieved by the federal government reinvesting that $2 billion a year over 10 years. So it is not a figure to appal one; it is really quite a reasonable figure in the context of the overall revenue stream from organisations like Telstra and the normal reinvestment levels.

To achieve Telstra's high profits to the last six months of last year, Telstra again, in my view, significantly underinvested in its network. It was investing only 16 per cent of its revenues for that period in capital expenditure, largely on the network, compared to figures more in the mid-20s, like 24 or 25 per cent, in the 1980s and indeed in the year leading up to the first partial privatisation of Telstra in 1997. So it is quite easy to manipulate a higher profit for Telstra in the short term by underinvesting in that particular period.

If it is not going to be politically possible to structurally separate Telstra, which I continue to believe is the best solution in the interests of both competition in the industry and achieving those national aims which competition cannot achieve—which I have mentioned: regional, community and national equity—then it is worth discussing the other option. That has been called operational separation, where you allow the one board to own the wholesale infrastructure of Telstra as well as the rest of the businesses but operate them separately and with enough transparency that a regulator on behalf of the industry can be confident that other telecommunications carriers buying wholesale capacity are getting it on the same terms as Telstra's retail business.

The first point I would make is that, if this is going to happen and it is going to be a meaningful exercise, delivering those public policy ends that the ACCC and others are seeking, you cannot leave it to Telstra alone to decide the boundaries between its wholesale and retail operations. You have to ensure that the separation is driven by a specification of the desired outcomes from the regulator and that you get some independent verification that these are being met. Secondly, I believe that you will not be able to achieve that operational separation without systematically having Telstra nominate exactly which pieces of its network, its systems and its staff belong to one or the other operation.

It is not as though this kind of exercise has not been done in the past. When I was a general manager in Telecom Australia and then Telstra in the late 1980s and early 1990s, we had transfer pricing between the network engineering department and the retail businesses. So in those days the company itself, without any external prodding, created the accounting regime to ensure what would be the wholesale pricing from the network infrastructure areas out to the retail businesses. That can be done again.

The other point I would make is that I do not believe that it is necessary to impose this regime across the whole of Telstra's infrastructure. I think it needs to be done only in those areas where it clearly does have a monopoly role in the industry. For example, you could exclude the mobile areas of the network—where Telstra has not had a dominant market position since about 1994—from that regime if you wished to. I hope that answers your question.

Senator CONROY—I wanted to get a little bit technical in terms of how you achieve the operational separation, and you have outlined a model, I think, previously in some of your papers. Is there a chance that drawing the line in the wrong place could inhibit future innovation? This is one of the arguments I hear against structural separation.

Prof. Gerrand—No. These arguments tend to be along the lines that, once you have government ownership of some business, whether it is telecommunications infrastructure or anything else, shock, horror, you have a total lack of innovation. Under that argument one would have to ask: why does the government continue to own CSIRO—is CSIRO incapable of any innovation? Are the ABC and SBS incapable of any innovation? The answer is: these are very innovative organisations.

Coming back to telecommunications: if you actually look at the level of innovation which was performed by Telecom Australia/Telstra to the point at which it lost its monopoly, it was extraordinarily innovative. In fact, it had the luxury of a long-term investment horizon, of a board prepared to accept seven-year business plans for roll-out of national infrastructure. I am

not privy to what time scale is set by the current Telstra board, but I would be surprised if it would accept many business plans with an investment pay-back period of longer than 12 months, because of the very strong pressures on it by the financial institutions in the market. So that is a very big difference.

There was a huge amount of innovation in the 1980s. It was the period of the digitalisation of the network, the roll-out of the first mobile networks, the roll-out of high-speed networks, microwave links out into the remote areas of Australia—and I could go on. From a purely technical point of view, looking at technology products and services, one could even sustain an argument that there was a higher level of innovation then, in the 1980s, when the organisation was prepared to be first in creating new services, than in the last 10 years, when the organisation has taken a commercially safer position of being a world follower rather than a leader.

Senator CONROY—You mentioned a paper you had written and possibly submitted to a different inquiry. Is the committee able to get access to it from the previous inquiry?

Prof. Gerrand—Yes.

Senator CONROY—Thanks. That will save you from tabling it. Who would operate Telstra's exchanges under your model?

Prof. Gerrand—It would be the network infrastructure company. When I say exchanges, I would again see no need to include the mobile exchanges in that—for the reason that Telstra does not have a dominant position in mobile network infrastructure—but certainly those on the fixed network.

Senator CONROY—Would retail operators have a right to install infrastructure in these exchanges?

Prof. Gerrand—Yes, and I would argue that if you had a clear demarcation of roles, so that a wholesale infrastructure company was being judged on its performance of winning retail business, you would get a very different attitude towards expanding physical capacity and exchanges to permit that, rather than the frequent operational difficulties which Telstra has raised over the last 10 years to providing such accommodation.

Senator CONROY—Do you get a sense that it has stymied its infrastructure wholesale growth to protect its retail income? I get a sense that that is what you are alluding to. Someone described it as trying to squeeze every last cent out of the copper.

Prof. Gerrand—It certainly makes perfectly good sense to squeeze every last cent out of the copper, and I would not criticise Telstra for that. One notes that the ACCC has had to force cheaper and much more reasonable wholesale prices for access to the local loop out of Telstra. Without the ACCC's actions, you just would not have got the extent of retail activity, particularly in the broadband market. I cannot comment myself, because I have not been a direct player in terms of some of those issues of difficulty with getting access to exchanges, but the ACCC has reported on it.

Senator CONROY—Why does Telstra restrict broadband speed to 256 kbps? I am told that, technically, the box can go faster.

Prof. Gerrand—It can. To be fair to Telstra, even in its current commercial offerings, it does not restrict you to 256 kbps. That is the sort of entry level that it offers.

Senator CONROY—But the entry level from a lot of its rivals is a lot higher.

Prof. Gerrand—I guess they are trying to get some competitive advantage on that. I would imagine that, given that Telstra has been dealing largely with a sunk investment on its copper network, where the majority of households, at least in the metropolitan areas, are within 3½ kilometres from the exchanges, it has looked at what bandwidth it can provide within 3½ kilometres.

Copper is not necessarily a restrictive media for providing very high bandwidth. It depends on the length of the copper. If you have a very short length, you can quite easily provide tens of megabits per second. It is just that the further you stretch it out the various effects of electrical engineering reduce your capacity. Coming back to your original question, for as long as there is not an effective separation between Telstra's wholesale infrastructure activity and its retail services, of course the retail business will get priority because the company as a whole is being driven on its commercial results. It is a natural mechanism. You cannot blame Telstra for doing this. It has been set up as a publicly listed company to become as profitable as possible. However, this activity is not in the national interest.

Senator CONROY—Some of the other infrastructure is close to the heart of Telstra's network. Where would that finish up in your delineation, including intelligent network features?

Prof. Gerrand—Coming back to the point I made in response to your earlier question about the technical difficulty of separation, the real issue is the cost effectiveness of the separation. If you are going to come up with a separation which is too costly, you are defeating the purposes of the separation. Therefore, my recommendation is that, in separating out the wholesale infrastructure, whether it is done with full structural and ownership separation or operational separation, it makes very good practical sense to keep the fixed network links, largely optical fibre, that interconnect exchanges, in the wholesale network business. I think this for several reasons. One is that, certainly between the major capital cities in Australia, there is already competition from Optus and the NexGen optical fibre links, and also there is a ready-made interconnection infrastructure around this trunk network, which can be used for the future as well. I may not have done justice to the last part of your question about exchanges. Would you repeat it?

Senator CONROY—It was about intelligent network features.

Prof. Gerrand—The term 'intelligent network' broadly refers to the use of advanced telephony features by using caller line identity, passing it from a local exchange elsewhere, so that knowledge of the A party, whether for billing purposes or for validation of identity, can then be used to provide a whole range of other services, such as phone card services, providing call redirection through 1300 or 1800 numbers and things like that. As with most telecommunications services, there is an infrastructure attribute of what you find in the

exchanges, which can be wholesaled out, and then there are retail aspects. Many of these services involve the vendor having their own database on a PC connected to the network which checks out who the A party is, have they paid for the service, and if they have paid and there is enough credit left on their phone card, for example, they will then connect that call to whoever the A party is indicating, whether it is in Australia or the rest of the world. So that latter part is the retail part of the business. The great advantage of intelligent network services for retail investors is that the level of investment is very low to achieve these services because they are piggybacking on all that sunk network investment, whether it is in the exchanges, in the access networks or in the long-distance networks, which is why phone card services are so amazingly cheap.

Senator CONROY—Finally, the ACCC has made a submission to this inquiry, giving what it believes are the necessary minimum ring-fencing arrangements in operation for separation. I want to run through these to see if you think they are enough or you think they need to be more stringent. It is suggesting that the two arms have to deal with each other on a commercial arm's length basis, including explicit pricing, invoicing and billing.

Prof. Gerrand—Absolutely.

Senator CONROY—They should maintain fully separate accounts and financial and non-financial reporting systems capable of capturing all transactions between the businesses and maintain separate staff at all levels.

Prof. Gerrand—Yes.

Senator CONROY—There are a few others, but they are three of them. Are there any other really big ones that you think are crucial? Some people suggest they need to be living in different buildings, for instance, for it to truly work. It would be a Chinese brick wall rather than the traditional Chinese wall.

Prof. Gerrand—I think it would be appropriate to have separate secure entrances to the different businesses. They do not have to be in different physical buildings. The issue of commercial protection of information is so important in the business world that it would be relatively cheap for each of these different businesses to have their own password entry into their building floors, where that password information was run by a separate system. It would be very simple to implement. It would be the least expected by Telstra's retail competitors.

Senator CONROY—Are there any other things which you think are absolutely critical to that ring-fencing? I appreciate your position, which is that structural is best. If this can be called a second-best, what else do we need?

Prof. Gerrand—I believe that it would be advantageous to have the wholesale business run by its own board, which would be a subsidiary board to the main one. Its directors would be responsible to the wholesale business. Issues of conflict between wholesale business and retail business that would naturally arise would have to be resolved at the main Telstra board, but at least you would minimise these numbers of areas of potential conflict by having a separate board for the operational company.

Senator CONROY—That is the sort of model that BT are looking at with Ofcom. One of the Ofcom suggestions is to have a staffer of Ofcom actually on that wholesale board. Do you think that is necessary or do you see potential conflicts there for Ofcom?

Prof. Gerrand—I think that would give a conflict of interest to the regulator.

Senator TROETH—I am interested that you raised the question of Cranbourne, which I last dealt with about seven years ago. I have been absent from the scene for a while. I am interested that it is still bubbling along.

Prof. Gerrand—Yes, it is. It is still unresolved.

Senator TROETH—As you would appreciate, it is still a particularly Victorian question, but I gather from what you say that it would affect the outer suburbs of Sydney as well. I never got to the stage of finding out that it was actually a legislative change that was necessary. I take it that would be at the federal level, in the Telecommunications Act.

Prof. Gerrand—I understand that the City of Casey does have formal correspondence from Telstra which indicates the particular legislation. I must admit that I have forgotten which act it is.

Senator TROETH—That is fine. But I am astounded that it is still unresolved, particularly as you mention the very large population growth in that area.

Prof. Gerrand—Yes. It has not been one of the big, sexy issues in telecommunications which gets coverage in the *Financial Review*, but it is obviously very important to the residents of Cranbourne.

Senator TROETH—Of course it is, and it may well affect other outlying areas as Melbourne expands further. I am pleased that you raised that. I also wanted to ask you briefly, although you have not mentioned it in your submission or your remarks, about the future role of what is now the merged ACA and ABA. Do you have a view on how that will impact, or how it could or should impact, on the regulatory regime?

Prof. Gerrand—Because Telstra is already running multimedia businesses with pay TV and Sensis as well as the traditional telecommunications products, it is appropriate even now that its technical regulator should have expertise and powers across different media. Once Telstra, through the T3 process, becomes liberated to make much freer business decisions on expanding its media empire, it will be that much more important to have regulators that are very competent across media boundaries. This applies just as much to the economic regulator, the ACCC, as it does to the more technical regulator, the ACA. The ACA's merger with the ABA into the ACMA is a good step towards that. My understanding is that, at the moment, ACMA's functional powers are no greater than the combination of the previous ACA and ABA acts, but at least through having the same organisation its board will become a lot more sensitive to issues which cross media boundaries and it can make recommendations to government if it feels that perhaps it needs additional powers.

CHAIR—Thank you very much, Professor Gerrand. We much appreciate your time this morning. Your input is always helpful.

[10.05 a.m.]

DODDS, Mr Christopher Phillip, Chairperson, Telstra Low Income Measures Assessment Committee

CHAIR—Thank you for your time today; it is much appreciated by the committee. You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I invite you to make an opening submission before we move to questions. We do have a copy of the LIMAC report as at 31 September 2003 with us. We read it with great interest.

Mr Dodds—There is a new one out. Unfortunately, it is out in a fortnight's time. We tentatively asked the minister's office if she could bring the launch forward and she was not prepared to, unfortunately. Thank you very much for the invite.

CHAIR—When the report is released, could it be forwarded to this committee?

Mr Dodds—Absolutely. I am sure the department would have intended to anyway. I have the privilege of being the elected chairperson of the Low Income Measures Assessment Committee. That is a committee that was formally constituted on 3 June 2002 and is made up of Anglicare Australia, the Australian Council of Social Service, who I represent on the committee, the Australian Federation of Homeless Organisations, the Council of the Ageing/National Seniors, the Department of Family and Community Services, Jobs Australia, the Salvation Army and the Smith Family. We also have observers from the Department of Communications, Information Technology and the Arts, the Australian Communications Authority, Telstra—obviously—and St Vincent de Paul, who play a major role as an equal partner with the other four major charities in the distribution of Telstra's bill assistance vouchers. We thought it was appropriate that they have observer status at the regular committee meetings.

It is important to start by saying that, while we have 'low-income measures' in our name and the ACCC gave us a whole chapter in their recent report on pricing regulation, we are not about low-income measures per se across the board. This committee and the package were part of a process to establish a compensatory mechanism for low-income, low-use users in the context of what in the industry is known as rebalancing. That was the ending of the cross-subsidy between the retail prices that were charged to consumers on their telecommunications and the charge for rental of their line. That was a competition policy initiative endorsed at every political and economic level, as with all of these economic rationalist type approaches creating a level playing field and all of the rhetoric around that and making costings transparent.

This was so that as the cost subsidy ended there would be a lowering of call costs and an increase of line rentals. For your average user there would be no difference in the monthly or three-monthly bill and for your high-end users there would be substantial advantage. A number of the organisations who are now represented on the committee identified that for low-income, low-use customers having the monthly line rental increase of—these are very rough figures—from around $15 to about $30 or $32 would be a fairly substantial increase for a low-income person who, if they were a low-end or low-spend customer, as Telstra calls them, would not get

the advantage of the rebalancing. So we entered negotiations to see what could be done and we achieved some very substantial outcomes in terms of the different products that were able to be agreed upon at a political level—with the Democrats' intervention in the last pricing regulation added to that package.

In particular, the two substantial ones were the product that maintains a low rental level per month in return for higher call costs. If you are a low spend user that is of advantage. The other one was the linking of the pensioner concession that Telstra provided in addition to the government's pensioner concession to the line rental increase, so that for all pensioners—and that includes aged, disability and single parent pensioners—there has been no impact from the line rental increase at all. That is because the pensioner concession has been indexed against the line rental increases. That, we thought, was a fairly substantial outcome.

Having said that it was mainly a compensation package, as part of the negotiations with Telstra we identified some issues for other utilities, albeit that they would be paid for via state governments and not out of the utilities' pockets. State governments have provided bill assistance schemes. In New South Wales that is called EPA and it is for all energy customers. If a person cannot pay their bill they can get a voucher. Telstra accepted our suggestion that they introduce that. They also introduced a range of support products: in particular, message box for homeless people who had no telecommunications. That was an add-on and a bonus on top of the compensation.

The reason I emphasise the issue about it being compensation free balancing is that I think that in the context of the committee's inquiries—particularly about consumers and the USO—there is a critical point here. Low-income and low-spend consumers have to a reasonable extent some protections. Those protections, thanks to the government's approach, are future proof—that is the telecommunications cliche. They are future proof because the whole package, including the committee and its role, was actually made a licence condition. That is pretty unique.

I as president of the New South Wales Council of Social Service have sat on a number of consumer councils with utility companies. We have other people who deal with the water companies. In my role with ACOSS I have sat and still sit on Telstra's consumer council. I know lots of people who sit on Optus's consumer council. These councils exist at the whim of the company, basically and fundamentally. The only group that involves organisations that represent the interests of consumers—the only one that has that as a condition of operation—is the low income measures committee. It is a unique position that I believe is quite badly needed in other areas with other utilities, given that exactly the same thing is going to happen from an environmental point of view—prices are going to be pushed up to discourage use and low-income people are going to suffer. Approaches like this provide a very good model.

However, for low-income people in general—and particularly high use low-income people—the USO is critical. A commitment to ensure that there is universal access is as important for people who are income disadvantaged as it is for people who are disadvantaged through living in rural and remote areas and for people who are disadvantaged through being disabled. If parliament and the Australian government are committed to ensuring universal and equitable access then the USO—as a general principle, not even just in the context of privatisation, and ACOSS has certainly argued this in their submission about the USO—should be expanded to cover low-income people and it should be a requirement that all telecommunications companies

have packages along the lines of, as a starting point, the low income measures committee and the access program package. That package also needs to be broadened to reach beyond just low spend customers. That is my opening statement.

CHAIR—I notice LIMAC did research work on the extent to which the program meets the needs of low-income disadvantaged Australians. Have you done any formal work on how the measures which were introduced in 2002 have stood up in a financial sense vis-a-vis the rebalancing? Can you say with any confidence that low usage customers who are covered by the access for everyone measures have not been disadvantaged by rebalancing?

Mr Dodds—Yes and no. I am not going to be definitive on this. We did the first round of research—and we have Telstra's commitment to keep funding research. With the second round, we wanted time for it to settle in. We have commissioned, and got the results back from, the second round they were funding. That was specifically targeted at the two groups we had identified as the most disadvantaged: homeless Australians and Indigenous Australians in remote and rural regions. That is no surprise to anyone who knows anything about telecommunications. The Estens inquiry identified those particular groups. So we used the money to be more focused. The research we commission this time will be a repeat of that first research. It is in that research that we hope to get some absolutely definitive answers on that question. However, we do know, for example, that Telstra have met their commitment to indexing the pensioner concession. I apologise, I should have my act a little bit more together than it is but the average pensioner concession now is about $12, which is double what it was when the package started, give or take a dollar here or there. But it has matched the line rentals so that we do know, absolutely and fundamentally, that every pensioner who is receiving Telstra's pensioner concession is no worse off than they were at the start of this round of the rebalancing exercise. I qualify that by saying that I mean every pensioner who is receiving the Telstra entitlement.

We have had real difficulty with Centrelink on a range of issues, in particular with their and Telstra's lawyers interpretation of the Privacy Act and with having an arrangement whereby—it appears so simple to me and I find it really frustrating that we cannot get a validation—we get messages sent out to everyone in Centrelink saying, 'You are entitled to this entitlement.' In terms of the messages sent out to people—for example, the measure that the Democrats specifically argued for, which was a product for low-income health care card holders—we have attempted and attempted to negotiate a message to be sent out via Centrelink saying that this product exists. They have argued consistently that they cannot be seen to be favouring one telecommunications company over another, even though there is not another telecommunications company in Australia that has an equivalent product. Quite frankly, from research I have done on a voluntary basis, I find it hard to identify another company in the world that has an equivalent product—maybe in Ireland. I have to look at the one that the ACCC found. I find it really frustrating.

The other thing that has happened in the past with utility companies, as they were government organisations, was that there was data matching of the computers. Since then, Telstra's lawyers have referred to the Privacy Act—and Centrelink's lawyers have said the same thing. I understand that there needs to be a change of legislation to get that data matching. When that happens, I think we can be really confident. Telstra can do data matching with Centrelink to make sure that everyone who is entitled to it is getting it and those who are not entitled are not

getting it. But, more importantly, those on a pension should be notified, and that is really the critical issue.

CHAIR—Which leads me to the issue I wanted to touch on, which is that in your research you found that the comparisons between 2002 and 2003 showed a decline in awareness, particularly for InContact and the various schemes. What would you suggest we need to do to ensure that these measures are better known to your target groups?

Mr Dodds—I think there are two things to say about those results. You hire these researchers and they go out and do a very generic research program. One of the messages that all of the organisations on the committee have been trying to sell to Telstra is that disadvantage is not homogenous. If you are disabled and on a low income, you have a whole set of problems. You have a whole circle of networks and contacts and you live in a certain space. For remote, rural and Indigenous communities, it is completely different again. Those generic advertising campaigns where you let the general population know that these products exist are the sort of thing that the public relations divisions of the corporations really like. But, in terms of communicating with the people you are trying to target the message to, they have limited value. So we have been spending a lot of time talking with Telstra and using our expertise.

For example, the Australian Federation of Homeless Organisations has worked very closely with the people in Telstra who are responsible for the products that are of specific help and use to people who are at risk of homelessness, have been homeless or are making a transition away from that. They are getting the messages from and communicating with particularly the organisations that work with those people. So given the crisis that someone is in when their marriage has broken up or maybe there has been domestic violence, telecommunications issues are the last thing they want to know about or worry about. But the people that are helping them, particularly when they are setting them back on their feet, need to know that there is a service called InContact, which previously was just a phone in the house that you could dial 000 from and you could receive incoming calls on but has now been quite dramatically improved. You can now use a pay card, you can ring a range of 1800 numbers and you can ring reverse charges from it, so you have actually got the equivalent of a pay phone in your home. That is a really good product for someone who is just moving in. There is no line rental and no cost of installation. All you need to do is provide the phone, and welfare agencies can provide that phone. It is an incredibly useful and invaluable product. When you are telling people in general about that, they say, 'I'll never need that,' but it is needed at the point of crisis. We have worked really hard with Telstra in saying, 'Look, we've got to skill up the agencies that are out there that work with people at those crisis points to communicate with them when they need the product.' These are things that you need only at points of crisis in your life. People go through cycles, and they come out of them. So that is what we have been doing about that.

At the same time we are still happy to do the public relations thing. Next month will see 10 years of InContact in Wollongong. InContact, just as the phone in your home that you could dial 000 from, has been there for 10 years. ACOSS and other agencies negotiated that with Telstra 10 years ago. It was launched 10 years ago in Wollongong. We will have a 10-year anniversary in Wollongong in mid-May. That is going to be really exciting. We will certainly get local publicity and we hope to get some national publicity about that, and that will flow on to agencies who will say, 'Yes, use InContact.'

CHAIR—I come to my final question. It is looking forward a bit. You talked about the importance of having these provisions in the Telstra licence conditions and about the suggestion that they should be included in the USO. Looking forward to ensuring that low-income people are adequately dealt with in the future, what would be your suggestions, if any, for changes in the regulatory system to ensure these needs are met? I am thinking in particular of new products coming online, such as broadband. I am thinking of all those poor, struggling university students trying to get by without broadband.

Mr Dodds—I can think of a couple of things. First of all, I am thinking of linking in a range of other initiatives that are happening. The ACA have been working with all of the telecommunication companies on trying to make them aware of the issue of hardship policies. Yarra Valley Water developed an approach to hardship policy that was quite unique in Australia. I know that from my seeking out of further information. I actually work in my paid job as a policy officer for the Energy and Water Ombudsman so I am really interested in the whole issue of utilities and hardship. Three-quarters of our complaints are about disconnections. For a long time telecommunication companies have not thought about it, but in particular, coming out of the inquiry that the ACA ran into 1900 numbers and unexpectedly high bills, the whole issue of hardship policies has come along. I think that, in terms of protections for low-income people, an approach that probably looks at self-regulation and at the failure of legislative regulation that makes hardship policies a requirement is a really critical issue in terms of a range of potentials as new technology comes into play. Think of the sorts of horror stories we got about teenagers and their mobile phone bills when text messaging came in. Where are we going to be in two years time when 3G is everywhere and sending a video of what is happening at a party to everyone you know because it is really funny starts happening? The potential for unexpectedly high bills for families and teenagers is quite enormous.

Senator CONROY—Have you talked to Telstra about putting a soft cap on these sorts of things, or a hard cap? Have they agreed to it?

Mr Dodds—I am wearing a separate hat now because I am on their consumer council. We have been working very closely and Telstra are taking on a range of those sorts of initiatives—

Senator CONROY—Kids, by definition, do not have much income. They are certainly in the low-income category, but the tabs are being picked up by their parents.

Mr Dodds—Yes. And the other area that this automatically flows into is the push for prepayment for low-income people. I think that is a generic issue.

Senator CONROY—Do you think prepayment is a good concept for low-income people?

Mr Dodds—No. I am saying that is where the push is towards. The reality is that a really significant number of low-income people are turning to prepaid phones. It is an ongoing project. I do not have any glib answers off the top of my head, but I think that, as part of the next step in dealing with the next generation and the changes and in providing protection for low-income people, we have to start looking at the mobile market and at how to involve the mobile providers, including Telstra. They are outside of this package because it is about line rental. We have to look at how we can get resources and support to people who are having difficulty in that mobile market.

The final thing, of course, is the whole issue of broadband. There are all of the cliches of a smart country. One of my colleagues, who is in a range of these telecommunications things is the President of the Isolated Children's and Parents Association, Jack Beech—you may well have come across him at one time or another. He often talks at length, but he is one of those bushmen who come to a really succinct conclusion. He says it is like driving a herd of sheep: it does not matter how fast you drive the head ones; what is important is when you get the last one through the gate. That is what is important with broadband.

Where this country is going and the way we do business—the way people do business with Centrelink and with government in general—is heading towards a broadband environment. I think we need a national plan that is not just something as simple as the low-income measures committee that is providing support on the edge. These are bandaids. The issue of broadband is so critical that it needs a strategy. There are probably some bandaids that would help, but I think a national access plan is the approach that needs to be taken.

Senator TROETH—I do not have any questions. I congratulate you on the work you have done. I have not heard of these initiatives, which is probably not your fault, but for a senator's office to be able to ask people to look at these is very helpful. It is an excellent program.

Senator CONROY—You mentioned that you believe that your package was future proofing and that these measures were future proofed. Can you point to where in the licence conditions it says that they have to index?

Mr Dodds—No; you're absolutely right. In that sense, I suppose—

Senator CONROY—The licence just says they have to have a package.

Mr Dodds—Yes. So the details of the package are—

Senator CONROY—Whatever they want it to be or whatever they are prepared to agree to, ultimately.

Mr Dodds—Yes. My sense—and you can only go on these things—from being involved both in negotiations and in the higher level commitment that has been there in the past and is there at present is that the package is fairly secure as is. Whether there is room to negotiate or expand it hinges on about three things. One is where government and regulation will want to see a program like this go. That is pretty critical. I think the intervention that the Democrats made in the pricing legislation last time saw an increase in the package of $10 million or thereabouts.

Senator CONROY—It wasn't something that Telstra were offering up?

Mr Dodds—No. With all due respect, I think that if the ALP, instead of just being absolutely critical of the line rental increase—and I understand the political raison d'etre for that—had gone we could have seen the package increase significantly more. So there is a role for the politics and regulation. The second is where the pricing regime goes. The ACCC's recommendation is now before the department and the minister. If there is to be a further round of rebalancing, and who knows what—

Senator CONROY—I was going to come to that question next.

Mr Dodds—I was going to say that, if there is going to be a further round of rebalancing, our view in terms of the impact on low-income people would be to say—

Senator CONROY—Do you support a further rebalancing? Do you think line rental should go up?

Mr Dodds—Quite frankly, the committee is about overseeing it. At a personal level and from ACOSS's point of view, we have always argued in favour of cross-subsidy. We believe in cross-subsidy. Given that the political commitment was to end cross-subsidy then I think it needs to be—

Senator CONROY—I do not understand why you say the committee cannot have a view on further line balancing.

Mr Dodds—Anglicare Australia will have its view; the Smith Family and the Salvation Army will have their different views.

Senator CONROY—So it will be: 'Don't mention the war.'

Mr Dodds—No, it will not be that at all. Each of the organisations sees their role on the committee as being to oversee the package and to negotiate further benefits for low-income people. We actually think that the whole broader issue of rebalancing and pricing regulation is for the broader political framework. Each of the organisations that are represented on the low-income measures committee will have a political position on that and join that argument and debate. If I were invited—

Senator CONROY—But if LIMAC put out a statement saying, 'We do not believe there is any justification for any further rebalancing,' that would be a fairly powerful statement.

Mr Dodds—It would, and it would be well beyond our brief.

Senator CONROY—So you are not allowed to criticise Telstra?

Mr Dodds—That is not it at all. And it would not be Telstra we would be criticising; it would be the government.

Senator CONROY—It is Telstra's decision on the line balance. They do not have to do it.

Mr Dodds—I am afraid I have a completely different point of view from that. I think that the line rental balancing exercise is driven by the Productivity Commission and by those political organisations and governments that believe in competition policy, introduced it and pushed it hard. It was done in the context of level playing fields to reduce and end what was seen as untransparent cross-subsidies. I think that argument was lost years ago in this country. At every level, government has committed itself to and endorsed the concept of competition policy. Therefore, in that context I think the obligation on organisations who have a role looking after

people who are disadvantaged is to win the best protections as that economic process goes on. However, I do not give up.

Senator CONROY—There is no serious justification for a further line balance at this time.

Mr Dodds—If there is not then—

Senator CONROY—Seriously, this is about fattening up the cow to sell Telstra. There is no serious justification for it. There is no economic justification. I do not believe, Mr Dodds, that you could sit there and tell me that there was. All I am asking is why you are not saying that.

Mr Dodds—I will stick to my answer. I think the role of the low-income measures committee is to oversee the package. I was about to say that, if you had invited the Australian Council of Social Service to appear before you and I was doing that representation, I would have a different answer. I am here as the chair of the low-income measures committee.

Senator CONROY—You said earlier that you felt that the package was pretty safe as it stands at the moment. Do you think Lifeline thought their package was pretty safe?

Mr Dodds—Lifeline knew from day one of the three-year contract that they signed that it was a three-year contract.

Senator CONROY—Do you think they expected to be terminated at the end of three years?

Mr Dodds—My understanding is that they were told the whole way through that it was going to be terminated.

Senator CONROY—Do you think it was reasonable for Telstra to decide to terminate it?

Mr Dodds—Can I answer that in two ways.

Senator CONROY—It goes to the certainty issue.

Mr Dodds—That is a one-line question but the answer needs to be quite complex. There are a couple of issues about that. Firstly, the move by government to see corporate philanthropy fill a hole that government no longer fills is one that has some inherent difficulties in it. One is that, once you make that connection with a corporate player, there are all sorts of public engagements that are really difficult to break. I think Lifeline felt that, once that engagement was there, it might well have been really easy to go on. In fact, they were proven correct, weren't they? The question of corporates disengaging is a really difficult one.

If the government—and when I say 'the government' I mean government as a whole and not this particular government—felt there was a need for a 24-hour service such as Lifeline's and they were going to fund it, no government at the moment in this country, Labor or Liberal, would automatically fund an organisation that is providing a welfare service. Right across the board, Labor and Liberal have introduced competitive tendering, and there are a range of other organisations that would argue that they had the capacity, the skills and the knowledge to offer the service that Lifeline offered. So what we had by default was a situation where the incumbent,

Lifeline, using public relations, maintained its relationship with Telstra. That is a different area altogether.

Senator CONROY—The issue was: under the current circumstances, Lifeline were able to play the PR game to protect their package. In the new circumstances likely after 1 July, do you think Lifeline could have pulled the same PR stunt—because that goes to the issue of whether you think under the new environment your package is as guaranteed or as future proofed as you think? It is only because, as you kindly say, the Democrats intervened in a political sense that you got an extra $10 million in your package. What happens if it is a public company not owned by the government?

Mr Dodds—After T3 is completed and it is a fully privatised company, I think that the pressures on that company from a number of levels mean that they will meet the obligations that they have. In terms of expanding it, I do not know. I am not a prophet. Given the right or the wrong employment choice as CEO—if you got someone who was incredibly economically dry—

Senator CONROY—A North American earning $10 million?

Mr Dodds—Whatever. If you got an economically dry CEO who felt that all of these things were properly and appropriately government policy, there could be a corporate change. In that instance—

Senator CONROY—You do not feel it is future proofed?

Mr Dodds—No. In that instance Telstra would have real difficulty and it would be up to the government what to do.

Senator CONROY—But you would not be saying anything?

Mr Dodds—Of course we would be saying something. We would be walking away if they said there was to be no low-income measures committee. What I was about to say is that, while I have not discussed this in the exact context of what I am about to say, I am 99 per cent sure I can speak for every member of the organisation and say we would be out the door the next day and Telstra would be left with no committee and therefore would be in breach of their licence conditions.

Senator CONROY—I was not suggesting that they would abolish the committee, because if they did that they would be in breach.

Mr Dodds—Well, they would have the committee with no members.

Senator CONROY—The issue is: if they reduced the package—and you have this unique position of actually not commenting on the overall package and what you think Telstra should or should not do—

Mr Dodds—I did not say that we would not comment on the package.

CHAIR—Does the minister have to approve the package or is it the Telstra board?

Mr Dodds—Telstra approve it.

Senator CONROY—It is not ministerial.

CHAIR—So it is entirely within Telstra?

Senator CONROY—Yes.

Mr Dodds—We report to the minister. So at the moment it is the minister.

CHAIR—Who determines whether Telstra has met the licence conditions—the minister or Telstra?

Mr Dodds—The minister. That is part of a report that we provide to her.

Senator CONROY—But the regulation just says 'package'; it does not say indexation, it does not say X, Y or Z?

Mr Dodds—Absolutely.

Senator CONROY—How many people have taken up your package and how many people do you think are out there? I know you have mentioned this problem with Centrelink. Is there a 50 per cent take-up, a 20 per cent take-up or a five per cent take-up of potential?

Mr Dodds—The pensioner concession, we think, is probably—and it is very hard to say—about five per cent short of where it should be. That could well be balanced by five per cent of people getting it who should not be getting it as well. Until there is some proper computer linking with Centrelink it is hard to say. In terms of the other major product, it is well over. For InContact it is about 70,000 to 80,000 people. All these figures are in the report coming out in the next fortnight.

Senator CONROY—Careful—you do not want to give us any scoops!

Mr Dodds—It is not that. When I got told I could not use it here, I left it at home. I could have given you the figures out of it, you see, but I did not bring it down with me.

Senator CONROY—It was safer to do that.

Mr Dodds—Certainly HomeLine Budget, which is the lower rental, higher call cost one, has been taken up at a far greater rate than we expected. I cannot give you a figure off the top of my head because I will be wrong, but it will be available to you within a fortnight. The one that has had no take-up whatsoever is in fact the one that the Democrats negotiated.

Senator CONROY—Hansard can't record Senator Cherry's blush!

Mr Dodds—Quite frankly, it is one of the real frustrations. We actually thought it was a good measure because it targeted people who were not on income benefits per se but who were—again using that cliche, but there is a reason why things become cliches—the working poor. We thought that was a good initiative.

Senator CONROY—So no-one has taken it up at all?

Mr Dodds—There have been a couple of hundred rather than thousands or tens of thousands, as it should be. The difficulty is in getting to those people. There is very little contact and there are not even all that many services servicing them. Centrelink is the obvious one—put a notice in. They would not come at it.

Senator CONROY—Who would not come at it—Telstra or Centrelink?

Mr Dodds—Centrelink. They would not come at sending out a message saying this product was available, because it would give a competitive advantage to Telstra.

Senator CONROY—That might actually be a good thing. It might convince Optus and the others to do it.

Mr Dodds—It is really frustrating. We have asked Telstra to repackage HomeLine Budget to incorporate some of the benefits that were in the low-income health care card, like an ability to pay installation cost across the first 12 months. That was one of the really good, attractive parts of that product. They are in the process of repackaging so it is the one product, and we will roll that out that way. It is one that gets a little bit more headline, and we will advertise that. So, rather than having a specific one that is only available for eligible people, we will make that part of HomeLine Budget, making a benefit for HomeLine Budget, and we will try and increase the take-up of that.

Senator CONROY—In this report, the ACCC states that a successful scheme needs to target low-income consumers rather than just low-usage consumers. Do you agree with that proposition?

Mr Dodds—I think that, if there is to be a low-income scheme, that is what should happen. That is where I start off—

Senator CONROY—Should we change your name to LUMAC instead of LIMAC?

Mr Dodds—This package was a—

Senator CONROY—But should we change your name to LUMAC instead of LIMAC?

Mr Dodds—We are stuck with the name the minister gave us.

Senator CONROY—Even though the name is ‘low income’ and you do not target low-income people? It is an anomaly in your name.

Mr Dodds—All of our products are targeted at low-income people. The primary products are targeted at low-income, low-spend people, and we won, in the process of that negotiation, I think some significant improvements for low-income people across the board. For example, until this negotiation took place, there was no Telstra Bill Assistance Program. That is $5 million every year that is provided to low-income and other Australians—not just low-income people—who are in crisis in their life, to help them pay their telephone bills.

Senator CONROY—But it is to compensate them for an atrocity from Telstra to fatten up the bottom line.

Mr Dodds—I strongly disagree with that. People enter into crisis and are unable pay utility bills.

Senator CONROY—I am not being critical of the fact the money is going there; I am saying that the reason that they need this compensation is because of a decision by Telstra.

Mr Dodds—No, Senator. People enter into crisis for a range of reasons, and when that crisis occurs in their life they have difficulty paying a range of bills that they normally can afford to pay. The bill assistance program and the EPA vouchers are not designed as a top-up every month or every quarter to assist people because they permanently cannot afford it; they are about crisis intervention at points when people are in crisis. For example, one of the groups who access the bill assistance voucher scheme is people who come from rural Australia to the city when their kids are being treated in for leukaemia or other things. All of a sudden, they have a telephone bill that is way above what they normally pay. That has got nothing to do with fattening up anything. It is about people having a change in their life that puts them into crisis and having a scheme that assists them to pay the bill that results as an outcome of that crisis. The organisations that distribute that money—Anglicare, the Salvation Army, the Smith Family and St Vincent de Paul—make those decisions every day with Commonwealth emergency cash relief. They are skilled and trained and have the expertise and make the criteria judgments on those things. They have approaches that do not allow people to just deal with their monthly bills by going there and getting it all the time.

Senator CONROY—Does Telstra's Access for Everyone program reflect this principle?

Mr Dodds—The Access for Everyone program is the name that Telstra markets the low-income measures under.

Senator CONROY—It is a bit of an oxymoron—access for everyone, except for everyone who does not get it. Perhaps we should change the name of that as well.

Mr Dodds—A number of the products are available to a range of people. InContact has been there for 10 years, and it is available to all low-income people.

Senator CONROY—I am just suggesting that perhaps the name should be changed. Frankly, it is misleading.

Mr Dodds—I beg to disagree.

Senator CONROY—It is called Access for Everyone, but the programs are not for everyone.

Mr Dodds—Obviously anyone who is a customer of Optus or AAPT is not eligible for any of these programs. That is right: Access for Everyone in that sense is as misleading as any other marketing cliché, and I can think of more than a few that have been associated with a range of political parties and a range of other commercial products out there that have been misleading in the same way. I accept that as a marketing issue. I will leave it there.

CHAIR—We have Optus appearing this afternoon. I am just wondering why these measures are not in Optus's licensing conditions?

Mr Dodds—I read in the paper on the way down here that they are about to put their line rental prices up next month, so maybe that is a really good question for them.

Senator CONROY—On page 106 of the ACCC's report it shows that consumers on Telstra's low-income plans who make an average number of calls—75 per month—and just a few capped calls may be worse off than consumers on standard plans. Is that a concern for LIMAC?

Mr Dodds—When we were negotiating this package with Telstra we argued that one of the groups that was going to miss out badly in the process of rebalancing was the group in which low-income, low-spend customers find themselves We accepted that the ACCC, the ACA and the department—and, indeed, the political process—would keep an eye on the overall package, to make sure that call costs did drop enough so that the average consumer benefited from a rebalancing. We said, 'What can be done?' and put forward a view that there should be a phone plan that maintained a line rental at a fairly low amount per month—and for that we were prepared to accept higher call costs. The regulatory authority accepted that proposal and made the requisite regulatory and legislative changes to enable, for example, the charge for a local call to actually be higher than the normal minimum charge.

Once you have a plan like that, there is always a gradient. At a certain point, it becomes disadvantageous for you to be on that plan and more advantageous for you to be on a normal plan. We have always said that. What we asked for and what we got was a protection that was not as good as the thing that we wanted and that the ACCC argued for—that is, an automatic transfer. But we got a protection that satisfied us that the greater bulk of people on the plan were protected. What happened was that Telstra agreed to initiate a process of, every three months—and then we reduced it to every six months—ringing people whose call patterns changed dramatically from a pattern that suited the plan, to ask them whether they were aware that their call pattern had changed and whether they wanted to be on another plan. That was so successful—in terms of the positive feedback they received from it—that they have introduced that process as part of their normal marketing arrangements. They now track a range of calling patterns, and they ring and let people know when there is a significant change. They are building that into their hardship program as an approach as well.

Every three months we were provided with a report about the number of people who were rung and the number who said, 'Yes, I am very aware of the change. I had a grandson who came and stayed with me for three weeks, and he made some extra calls, which put it up over the norm, but I am happy.' Something like about 95 per cent of all people contacted were aware of the change—and chose to stay on the calling plan and were aware of what it was. We were

happy enough with those outcomes that we actually reduced the requirement for getting a report back on that calling program from every three months to every six months. We think that, while it is not as good as an automatic transition, it is one of those quid pro quos. You accept the technical advice you get and, after considering the cost of making automatic changes, they argued that, with the protection there, it was not necessary.

Senator CONROY—Has LIMAC compared Telstra's package with the low-income schemes for telecommunications in the US and the UK? The ACCC pointed out that these schemes provide rebates or discounts: does that mean that the low-income consumer is never worse off under the scheme when compared to the standard package?

Mr Dodds—I spent a lot of time doing that comparison. Where they talked about discounts, particularly in the pensioner discounts, in every case in Australia where they compared it to utilities and where they looked at the UK and the US the comparisons they made were in fact with the government provided concession as opposed to the utility provided concession. Low-income consumers in this country get two telephone concessions: they get a Centrelink concession and they get the one Telstra provides. The comparisons were, in every instance, with a government provided concession. If you actually do the mathematics, which we did, the combination of the two is a false comparison—it is an apples and oranges comparison. No US telecommunications company offers a pensioner concession, full stop. That is the bottom line. None of them offer that. The federal government and some state governments offer some concessions, just as our federal government offers some concessions. The comparison that the ACCC used should really be used against the Centrelink concession and not the Telstra one.

Senator CONROY—I have seen a quote—I do not have it handy—from Telstra saying that the social package is in doubt if rebalancing cannot take place. Are you still feeling future proofed?

Mr Dodds—We had an assurance from the person who said that, Bill Scales.

CHAIR—He is appearing this afternoon too.

Mr Dodds—You should ask Bill about that specifically. My understanding is that what they were talking about was any expansion of it if there were to be significant changes in the process.

Senator CONROY—Let me read you his exact quote.

Mr Dodds—I read it as soon as it came out. I got the press release.

Senator CONROY—I will get a chance to follow this up with him, but you believe that you have an assurance that this is not the case?

Mr Dodds—Yes.

Senator CONROY—We will ask him about it and try and get him on the public record for you. Currently, consumers on Telstra's low-income plans pay a lower line rental but higher call charges, either 24c or 30c.

Mr Dodds—Yes, that is HomeLine Budget.

Senator CONROY—Telstra is allowed to exceed the 22c local call cap if the line rental charge is below the standard rate. Does LIMAC support the ACCC's proposal that the 22c local call cap should apply to low-income plans?

Mr Dodds—Yes.

Senator CONROY—That would go a long way to ensuring that low-income consumers are no worse off.

Mr Dodds—You would still have the gradient but it would shift the point where the change happens. Depending on the number of local calls you made—I can never follow the maths of all of this—it would probably be another $4 or $5 up the gradient.

Senator CONROY—Another issue raised by the ACCC related to the eligibility of consumers for rebates. At present, pension and concession card holders are entitled to rebates up to $12.25 per month but other low-income consumers are not. The ACCC suggested the benefits of the low-income plan should extend to health concession card holders. Does LIMAC support that?

Mr Dodds—We had initial negotiations which led to this package coming about. The welfare agencies, ACOSS and a number of the youth organisations in particular argued that the pensioner concession that Telstra provided should be expanded to cover health care card holders, full stop. The government and Telstra both argued at the time that that was exceedingly difficult and costly. I am not sure where your average length of unemployment is these days. I know there is a big lump of long-term unemployed, but the bulk of unemployed people turn over fairly quickly. Sickness benefits turn over fairly quickly. There is a huge turnover in the holding of a health care card. Certainly an expansion of the pension part of the program—and it is only the pension part—would be welcomed by LIMAC. We have discussed this a number of times. We cannot even get the pensioner concession card confirmed by Centrelink at this stage. So a step-by-step process would be of benefit there.

In terms of the cost, being really pragmatic about it, having Telstra come to the party with the added expense of the health care card holders would be an ask. I think the ALP had a role in the previous one, and that was one of the things we could have put on the table and negotiated and played really hard ball on. It was a significant increase in the cost. One of the things that has been raised—and we have discussed it—is that not everyone on a pension with a pensioner concession card necessarily has a low income. Again, there is a gradient with allowable income. It is a question of whether you reduce the pensioner concession eligibility further down the income track and make money available to give to health care card holders. But I think that is the sort of political decision that governments of most political colours tend to stay away from. It is something we have argued at NCOSS, for example, with transport concessions at a state government level and taking on particularly the aged, and our own members in some ways—COTA National Seniors have indicated that 'if you could do it fairly they would be interested in at least discussing it'. But it is a difficult process.

Senator CONROY—I would like to ask about the regulatory framework which underpins the low-income package and which goes to some degree to the future proofing that you were eulogising a bit earlier. The ACCC identified a number of deficiencies in the current arrangements—and we have covered some of them. There is no mechanism for LIMAC or the minister to require improvement in the low-income package; only Telstra can initiate changes; changes in the package do not need to be approved by any independent body; Telstra only needs to consult LIMAC; and Telstra is required to have a marketing plan but is not required to comply with it. The ACCC recommended that Telstra's licence conditions should require it to comply with a package and marketing plan that has been approved by the minister. Do you support that recommendation?

Mr Dodds—I was fairly critical of the ACCC's approach there. I think they (a) misunderstood some things and (b) are being politically unreal at one level. There are some aspects of it with which I agree. I do not think any corporation or government department would allow an advisory committee of this nature to be in a position where they can make binding recommendations about increasing expenditure. I think that is politically unreal and it is not going to happen anywhere. It would be really nice if it did, but I do not think it is real. I also think it is a bit disingenuous of the ACCC to imply that Telstra have a marketing plan and they do not comply with it. The reality is that this is a public, political process and we report to the minister in a public document. If we said Telstra presented to the minister a marketing plan that we disapproved of then all sorts of things would happen. I have sat on a number of these consultative committees, and the thing I find amazing about this one at Telstra is that Telstra's corporate people—their legal and regulatory people—overlook the minutes and make sure the people who have to implement what we say do so, because they see it as a licence condition. I agree that absolutely and in a strict legal interpretation they are not required to, but the reality is, particularly with the marketing plan, that they are taking our advice and implementing it 100 per cent. There is not a single thing about which we have said, 'We think you could do this better,' or 'We think you could do it this way,' that they have not done. Until they demonstrate bad faith, I am prepared to take their good faith.

Senator CONROY—Sure. But I just find it a little confusing that you switch between saying that we have to accept political reality and that this is a public, political process. Did LIMAC campaign or call for the changes that the Democrats suggested or achieved?

Mr Dodds—When we raised the bill assistance program with Telstra and they came back and said, 'We'll do $5 million,' if we had had our wits about us we might have said, 'Double that,' but we were so shocked that they accepted it that we said, 'That's really good,' because it was a really good offer. There were a number of things that, with hindsight, we could have and should have identified, but we did not. Looking at a specific product for the working poor was one thing we should have been more on our game about, but we were not. We welcome that some other players identified that.

Senator CONROY—But the issue here is that you have just been critical of the ACCC, telling them to get real politically—

CHAIR—Senator Conroy, you are coming up against time.

Senator CONROY—I appreciate that, but I am just following up the answer. You make the point that the ACCC needs to get real politically and then you want to not support the recommendations that allow it to stay in the political arena a bit longer.

Mr Dodds—As I said before, I have been involved in a number of these sorts of things—consumer councils et cetera—and I do not know of a single other one that is actually a licence condition. It is not a ministerial committee, but part of our job is to report to the minister. The fact that the ACA and DCITA observe every meeting indicates to me that the political level is fairly high, and we have senior Telstra people attending as observers and they implement our recommendations. So at every level I have been convinced that there is a solid commitment to the process.

Senator CONROY—Except when Bill Scales makes comments like this publicly and then has to privately retract them. I will finish there.

CHAIR—Mr Dodds, on the future-proofing issue, you mentioned, under your other hat, that ACOSS had put in a submission to the USO review. I wonder whether it would be useful for the committee to get a copy of that, and if you could put the request through to ACOSS.

Mr Dodds—It will be on the ACA's public web site.

CHAIR—I am not sure whether you want to take back to NCOSS or ACOSS the broader question about taking this further from a regulatory point of view. We have not asked ACOSS for a submission but we did advertise publicly. I know they are up to their eyeballs in work and submissions.

Mr Dodds—Telecommunications is my purview, and I juggle both the consumer council and the low income measures committee outside my paid work.

CHAIR—It is understandable, but if there is any material—

Mr Dodds—I think the ACOSS submission to the inquiry into the USO articulates the position that low-income subsidies should be a universal obligation for all the players in the market and, basically, a condition for providing telecommunications in Australia.

CHAIR—That is what I thought; we would not need a copy of that. We did not get into the issue of Telstra's marketing plan, but I was interested in the notion of how the word gets out about these measures. You spoke about Centrelink and I will take that up with Centrelink, but if there is anything further you can submit about that it would be appreciated. Thank you very much for your evidence today.

[11.04 a.m.]

PINNOCK, Mr John Edward, Ombudsman, Telecommunications Industry Ombudsman Scheme

CHAIR—Welcome. Thank you for your time this morning; it is much appreciated by the committee. We have received your submission which we have numbered 39. As you requested, we have not published one of the tables. Do you wish to make any amendments or additions to your submission at this stage?

Mr Pinnock—Not beyond a couple of typos, which are probably obvious to the committee. There is a typo in the note in paragraph 17: it should refer to the figures in table 2 rather than table 1. Table 3 refers to a projected figure in the current financial year of 13 per cent; that is probably going to be closer to 16 per cent. Apart from that, I do not want to make any amendments or changes to the submission.

CHAIR—Thank you. You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I invite you to make an opening statement before we move to questions.

Mr Pinnock—I do not wish to make an opening statement. My submission is in response to a request from the committee so I am happy to take it as read and answer any questions which the members of the committee might have.

CHAIR—I know that in previous evidence you have given to this committee on other matters you have spoken about the need to raise awareness about the TIO's work, particularly in rural areas. Has there been any further progress in improving the awareness of the TIO?

Mr Pinnock—I would have to say no. The issue of quite what is to be regarded as an obligation on individual TIO members is still a matter of some debate which has not been resolved within the council of the TIO, despite considerable discussion about it. It is my view that there should at least be a fail-safe mechanism—which does actually exist but, in my view, goes largely unenforced—and that is that if you are saying that the people who really need to know about the TIO are not consumers generally but, rather, customers with complaints at a particular time, then the best way of ensuring that they get to the TIO is that if they have an unresolved complaint which they have taken to their provider, that provider ought to refer them to the TIO. That is the short answer.

CHAIR—It is obvious.

Mr Pinnock—There is a rule to that effect in the complaint handling code which says that a customer in that position must be advised about external review mechanisms. The TIO is specifically referred to in that rule. It is my observation over a number of years, both in relation to the first version of the complaint handling code as well as the current version, that that is more honoured in the breach than in the observance. Consistently over the last three years our internal

figures show that somewhere between only 11 and 16 per cent of complainants come to us as a result of a direct referral by their provider.

Many of the members of the TIO, particularly the larger ones, argue about the validity of that figure. For instance, they will commonly say that in many instances they are left with the impression, when they have talked with the customer, that the complaint is resolved and therefore do not feel the need—or, indeed, that there would be any point—to refer the customer to the TIO, but subsequently the customer, out of their own conclusion, believes the matter is not resolved and then finds their way to the TIO. Well, I am sorry, I just find that a very convenient explanation for these very low referral rates. Even if one was to say that that can happen, and make some notional adjustment to our figures, I would think that still, in 75 per cent of instances, customers or complainants do not come to us as a result of a referral by their member. So that rule in the complaint handling code is simply not being enforced.

CHAIR—How would you improve enforcement with that code?

Mr Pinnock—If we are talking about enforcement as distinct from compliance, it is a matter entirely for the authority. It is the only point of contention between the TIO and the authority; it always has been.

CHAIR—Your figures show a significant increase in complaints over time. Does that suggest that there is decline in the quality of internal dispute resolution procedures?

Mr Pinnock—With the qualification that we are talking about raw numbers which are not standardised in any way and the problematic issues surrounding that, my view is that there is clearly an element of a declining performance on the part of the service providers. Even if you say, 'The market is growing and products and services are growing,' the one area that might show a decline in internal dispute resolution performance is what we loosely call customer service complaints. Five years ago these complaints did not exist. In fact, we used to have a complaint category called 'staff', because it dealt with rudeness on the part of staff, and it was 0.5 per cent of complaints. We then started noticing a range of different types of issues coming up which we lobbed under the general rubric of customer service. When you look in detail at what is involved in those complaints—failure to call back, failure to act on customer requests such as updating changes in address et cetera, failing to adhere to undertakings—you see that all of these sorts of things are now a very significant part of the complaint trends coming into the TIO. As I said, that category will make up roughly 13 per cent, perhaps more, in the coming year, and it is now well and truly at the forefront, after billing—we always have billing complaints—as a significant trend in terms of customer service overall.

CHAIR—The previous witness, and I think you heard most of their evidence, was talking about the importance of developing hardship policies across all carriers. Do you have any comments on the importance of hardship policies or how they are operating at the moment from a complaints point of view?

Mr Pinnock—Traditionally the TIO has had very little involvement in this area. Five years ago we would have done very little work in the credit management area. Credit management complaints were running at about seven per cent. They were in a group of complaints that had third place after billing and provisioning faults. Over the last two years, as we have seen with the

greater expenditure on the part of individual consumers in telecommunications, credit management issues have very much come to the fore. We have had unexpected high bills issues, the issue of providers' factoring of debts and all of these sorts of things

Along with that comes the question of hardship and, in particular, payment plans. When we dealt with payment plan complaints years ago, the general view of my staff was that they were not equipped to deal with them. There were a lot of issues involved which went to what might be regarded as the socioeconomic position of the complainant, which they felt uncomfortable with handling. We have overcome that. Hardship complaints are now significant as far as credit management issues are concerned. I would say that, as a result particularly of the authority's move to have a forum some two years ago with the Kildonan group to bring to the attention of the carriers the issue of hardship, there has been a considerable improvement—certainly on the part of Telstra—in recognising hardship. By the way, I think it is generally accepted within the telecommunications industry that, as Kildonan would say, hardship means when customers want to pay their bills but for particular circumstances, usually of a crisis nature—as Mr Dodds was referring to—are unable to do so at a particular point.

As you probably know, I have been critical of Telstra in the past but I would have to say that, although it has been somewhat slow this area—Mr Dodds would probably disagree; he thinks it has been remarkably adept—it is making considerable improvements. I had a briefing yesterday from Telstra officials relating to the development of their hardship policy and a trial that is being undertaken at the present time. I would think that, if that flows through to a formal program in Telstra, that would be pretty much in line both with a guideline that I hope is to be issued by ACIF—it is in a draft form at the moment, to considered by the ACIF board—and with the TIO's own position statement on this area. So I would think that Telstra has very much recognised this is an issue. After Telstra it is a bit of a mosaic. I do not think any provider that is a member of the TIO is nearly as advanced as Telstra in this area and, in fact, for some of them I would say that the whole idea of hardship is beyond them.

The most rapidly growing area of complaints in the field of credit management is of mobile carriers and resellers, where we see a significant degree of 'alacrity', can I say, in trying to have bills paid quickly and in the suspension and disconnection of services. We now have a situation where in many instances a mobile service is the only form of telecommunication service a consumer has and we are seeing a gradual movement from fixed to mobile services. I think there is a failure by the providers to recognise that they are providing what is, in effect, an essential service.

CHAIR—My final question is in relation to the issue of convergence and how that impacts on your bailiwick. Have you or the council had any thoughts about whether you need to expand to cover the pay TV and payment issues?

Mr Pinnock—We have had a lot of thoughts about it. My council is in the midst of grappling with the issue at the moment. There is, as you know, a recommendation from the last inquiry of the committee that the TIO become a CIO—a communications industry ombudsman—which, in broad terms, I support. But in another sense it begs the question of what is going to be included in there and what is not. At the moment I can only speak for myself because, as I said, the council and the board of the scheme are still grappling with the issue.

My view is that convergence is a very difficult and illusive concept to grapple with. If you try and make detailed statements about where one should go you are likely to be wrong. I would prefer to approach the issue on the basis of some principles. One would be that, irrespective of technology or the nature of the way in which services are offered, since the TIO is in a broad sense a consumer protection mechanism, we should move in lock-step with developments in the regulatory regime, which, in turn, should move in lock-step with industry developments.

The second principle is that the adequacy of protection which the TIO provides should balance legitimate and reasonable expectations of the consumers with the reasonable cost benefits that might be carried by the member, since it is a member-funded scheme. That also takes into account the fact that no ombudsman, whether a parliamentary style ombudsman or an industry style ombudsman, can ever cover all the areas of interest for consumers—so there are always going to be carve-outs. USO policy, for instance, is not a matter for the TIO.

Finally, although I said I should avoid clear statements, one underlying thing you should always insist on—and which we are in the midst of arguing about—is that if something is on a bill then the TIO provider that issues that bill should deal with all the complaints that arise from it. That is a particular issue at the present time and will become more so in relation to mobile premium services. In my view there is a detectable push-back, particularly from some of the mobile carriers represented by APTA, as well as from the resellers of mobile services, to try and say to their customers, not only in first instance but when the matters are coming into the TIO: 'That is a matter between you and the third party content provider; we are just billing for it.'

As far as I am concerned that is probably strictly speaking legally wrong in terms of what the TIO's requirements are but in any event it is a way of deflecting responsibility into a situation where you will never resolve the issue because, after all, it is the carriage service provider that is billing for the content. If you have a direct relationship with a content provider and the content provider bills you on your credit card, that is not a matter for the TIO.

The content providers do not have to belong to the scheme, but, just as it was with the old situation of premium service numbers in the fixed line area, where Telstra never, ever argued that the TIO did not have the right to deal with complaints, so it should be with this growing area of mobile content. If it is on the bill, the carriage service provider that bills the customer for that service has to take responsibility for it. In my view it does not matter whether they have a bilateral agreement with a content provider or aggregator of content to share revenue or whether they are merely acting on a fee-for-service basis as some form of billing bureau: if it is on the bill, they deal with it.

That is part of the reason, for instance, we say that we should have jurisdiction in relation to pay TV services: it is another form of bundling, if you like. Really, another way of approaching it conceptually is this idea of bundling. If the bundle is provided in any way by the carrier service provider, a member of the TIO office or the TIO gets to deal with the issues that arise out of the bundle.

Senator CONROY—Do you have jurisdiction over activities of ISPs? I am conscious of what you have just described there, but what about ISPs?

Mr Pinnock—Yes, they all have to be members of the scheme.

Senator CONROY—How many complaints did you investigate last year?

Mr Pinnock—We received 55,000-odd complaints—sorry, do you mean about ISPs?

Senator CONROY—Yes, ISPs.

Mr Pinnock—Pardon me for one moment; I am just trying to find the aggregated number. You would have to do a quick calculation: it is 15.3 per cent of 59,850. I am sorry; I do not have a calculator with me.

Senator CONROY—That is fine.

Mr Pinnock—By the way, I should say that that includes what I call level 1 complaints, which are referred back to the member at an escalated point, and, whilst we call them investigations, they are not what you might call formal investigations.

Senator CONROY—I was going to ask what was involved. I will come back to that in a second. Last month you issued a warning that ISPs should be doing more to assist consumers in making the right choice when they sign up for a broadband service. What sort of complaints have you been receiving about broadband services?

Mr Pinnock—Availability is the first one. Customers sometimes find themselves being given contrary advice by their preferred provider, which might be a small ISP, where the preferred provider says to them—and there are a whole lot of undercurrents here, as you might imagine, Senator—'You could always make inquiries of Telstra.' They are left in a situation where one provider might say, 'No, there is no service,' and the other might say, 'Yes, there is a service; come to us.'

Senator CONROY—We hear this regularly.

Mr Pinnock—That, however, tends to be dealt with a little better these days, simply because of the importance to Telstra of its own wholesale customers. So there are mechanisms for getting a better alignment of the advice or information that is given to customers as to the availability of a service when it is in effect the reselling of a service.

The other area—again, there are developments going on—which is a vexed area for consumers is the delays in transferring, or churning, from one broadband provider to another. This often gets down to the simple issue of the removal of technical or electronic codes that are on the service which identify it as being a broadband service provided by a particular provider as opposed to another. If they are not removed—and I have no idea how this is done in a technical sense, so please do not ask me!—

Senator CONROY—I would not understand, even if you did!

Mr Pinnock—then, when you go to plug it in, as it were, and push the switch, nothing happens. This has become quite an issue and, again, in fairness to Telstra, it is probably driven by competitive issues between its direct and wholesale customers. These complaints are starting to be dealt with a little better, but they are still an area of concern for customers. I might also say

that there again we have this argument, particularly advanced by Telstra, that the upsurge in broadband complaints is very much driven by what is now becoming a much more ubiquitous type of service, such as ADSL, so the issue coming to the fore is what the real complaint rate is.

Senator CONROY—Are consumers being misled about download speeds or broadband prices?

Mr Pinnock—I think there is an issue about speed. I do not think there is a real issue about prices. That does not seem to come through with us. The way that would come through with us is largely, or more commonly, whether there is a term contract where the customer wants to get out of the contract, rather than just a month to month or even a—

Senator CONROY—Perhaps they have been miss-sold on the appropriate package previously.

Mr Pinnock—There is always that issue. The issue of speed is always there. The performance of the service providers is getting better in the sense of addressing customers' concerns but, again, with this qualification: the comment I made to Senator Cherry about customer service and the lack of it, or the poor performance, across the board in telecommunications. We have three divisions at the moment under which we report landline mobile. Internet broadband falls under internet, and poor customer service is a significant issue across all three of those divisions.

Senator CONROY—Do you think the marketing of broadband has been misleading customers in some cases?

Mr Pinnock—Marketing is a pretty broad category.

Senator CONROY—To try to stretch the boundaries.

Mr Pinnock—No, I do not think I can honestly say that based on the statistics that we have. I think there are clearly consumer issues, but when I look at our figures the sort of feeling that is coming through is that in the internet space it is not an issue of misleading marketing. That is very much an area perhaps more in the mobile space, but I do not think we are seeing it in—

Senator CONROY—Is there any misrepresentation of speeds? They can claim it can deliver anything, but what it actually delivers is—

Mr Pinnock—There is an argument that expectations are built up and that performance does not always match what has been suggested. But, again, we would capture this under the contracts issue in broadband. Certainly contract issues have come up—there is the question: 'If I want to get out of the contract for any particular reason, am I faced with an unreasonable termination fee for something like that?' I appreciate your probing, but I do not think that there is misleading—

Senator CONROY—I sometimes think my own broadband is slower than the old dial-up on some days. I appreciate that that is a function of traffic and other things. We had an engineering expert in earlier who talked about technological constraint in terms of the distance from the exchange and speed. They do not advertise that it is 256 providing you live within five kilometres of the exchange.

Mr Pinnock—There is a class of broadband customer who are pretty cluey.

Senator CONROY—I am not in that category myself.

Mr Pinnock—Neither am I, but some of our complainants are. They would be very much the complainant who would be able to raise issues of speed. So when you ask me a question broadly as to whether there is misleading conduct, it is hard to know, because it does not necessarily come through from the greater mass of broadband customers, who, by the way, increasingly are inexperienced because they have never been along the dial-up route in the first place.

Senator CONROY—Should there be a qualification on these ads that says, 'Providing you live within five kilometres of an exchange'?

Mr Pinnock—If we are going to get down to that level of detail, my own view is that—

Senator CONROY—At least an asterisk which points to a little qualifier down the bottom.

Mr Pinnock—There are codes that deal with advertising—in particular, the ACIF prices, terms and conditions code—and, of course, there is the impact of the Trade Practices Act itself. As a general comment, and this is not restricted to broadband, I am personally very critical of a range of advertising in the telecommunications industry in relation to packages, bundling and asterisks. I was looking at one particular ad the other day—I do not recall its details—and it had an asterisk, a cross, a double cross and three something elses. It is impossible to present a fair package in that way. I am highly critical of the use of the word 'free'. My view is that, unlike section 92 of the Constitution, 'free' does mean free.

Senator TROETH—Except under certain conditions.

Mr Pinnock—Yes. Also, I am highly critical of things like unlimited download. 'Unlimited' is unlimited; it cannot be qualified. I do not like the use of acceptable use policies, which were once there to regulate unacceptable conduct, particularly in the internet space, but have somehow transmogrified into part of the cost of the package. Having an acceptable use policy means that you have everything free to a certain point and then suddenly it costs you. I do not like these things because they are not transparent, to choose the modern word. For instance, in some cases of acceptable use policies, they are so lacking in transparency that the TIO has not been able to figure out what they mean, so how can a consumer do so? On a broader scale, in any instance, the industry is getting away with a hell of a lot.

Senator CONROY—The TIO has often delegated responsibility under ACIF codes. Has the TIO ever taken enforcement action under an ACIF code?

Mr Pinnock—No, that is not our role.

Senator CONROY—Can you describe the level of your involvement with these codes and enforcement? When you say it is not your role, at what point do you drop out?

Mr Pinnock—We deal with individual complaints and we make assessments ourselves as to whether any individual complaint involves a breach of a code. We do that because the codes are

so little known by consumers that it is unlikely that any consumer will never come to us and say, 'I'd like to make a complaint about a breach of such and such a code.' So in the first instance it is a matter of characterisation on our part. Having investigated the complaint, whether by way of a level 1 referral or a formal investigation, we will have a conclusion as to whether the complaint is properly made out—and we have that for level 1 referrals where we have only the customer's version of it without a formal response from the member—or whether it is established after investigation. We have two further subcategories, depending on whether the member of the TIO is or is not a signatory to that code.

Every quarter we send those statistics to both ACIF and the ACA. The ACA also gains statistics on an annual basis from us for its section 105 report. Thereafter, the role of the TIO finishes, apart from commentary that we sometimes give to the ACA for its report. I believe that one of the reasons that the TIO has been a success—and I do believe it has been—is that we have a pretty fair idea of where our role begins and ends. Although we are often referred to as a sort of regulator—and I think the explanatory memorandum to the 1996 telco bill refers to us as a central element in a co-regulatory equation—we are not a regulator in that sense of the term at all. One of the boundaries is codes. It is not our role to require compliance with them or to enforce them. By the way, that is a distinction that the industry talks about now: the idea of compliance, in the first instance, being a matter for ACIF, as the developer of these codes—

Senator CONROY—They would be terrified of that!

Mr Pinnock—yes—and the ACA having clear powers for enforcement under part VI of the Telecommunications Act. That is not a role for the TIO. By the way, the only point of contention that I have ever had with the authority in relation to enforcement is the complaint handling code. Apart from anything else, it is just not my role to enforce, but enforcement involves a very delicate balance of when you do act and when you do not act. I understand the idea of regulation and I understand how difficult a decision can be. That is all the more reason for the TIO not to, as it were, substitute its opinion for the authority's.

Senator CONROY—On that issue, the Consumers Telecommunications Network has suggested that there has not been a high level of compliance with the complaint-handling code of practice.

Mr Pinnock—Yes.

Senator CONROY—The CTN stated that it did not believe that referrals were being made to the TIO as often as they should be and CTN were of the view that people were having trouble making complaints. What are your thoughts on that?

Mr Pinnock—I agree with all of those comments. As to the last, I assume that CTN is talking about complaints to their provider. I would have one qualification only there. It is my experience that providers do not, as it were, discourage people from making complaints, but some of them put positive barriers up to having complaints escalated. If I can return to the question about internal dispute resolution, with many of our level 1 referrals, where we send the complainant back to their provider yet again, we send them to an escalated service point in the provider, particularly the big ones, with a telephone number and our reference number. The telephone number that we give them is not usually available to them from the provider itself, so in some

ways our level 1 referrals are an area in which the provider ought to be dealing itself with the complaint in the first instance at an escalated level. If it were, the TIO complaints numbers would drop considerably, and so would our escalation rate. This would lead to the publication of these numbers to consumers generally, which the larger telcos will not do. They pay the price—and so does, more importantly, the customer—by the matter then flowing through to the TIO.

Senator CONROY—A recent report prepared by the Page Research Centre recommended forcing Telstra to obtain customer service accreditation. Do you have a view on that?

Mr Pinnock—I have a view about the second part of it where Page said that it was for the TIO to enforce this. No way! Again, quite apart from the fact that we are not skilled enough to do that, it is not our role. That is a classic enforcement role. I think, Senator, you would be better directing that question to Mr Horsley when he appears this afternoon.

Senator CONROY—Okay.

Senator TROETH—I have one question. In its new embodiment as the ACMA, do you see that body having any impact on the level of complaints and general consumer dissatisfaction that you have described?

Mr Pinnock—Not as it stands. The legislation simply substitutes one body for two. Legislatively and in a regulatory sense, everything runs on as it was before. By the way, people are critical of that. I think one of the reports of the committee talks about the legislation being a lost opportunity. I believe in hastening slowly in this area. There is always regulatory lag, and even more so in an area like the convergence. It took a long while for the UK to put its model in place because of the difficulties of figuring out exactly what was going to happen. Eventually, when the legislation is merged and ACMA and all its functions are wrapped together, it could have clear implications for the TIO. The big issue is—and I floated a kite on this a while ago; and this gets back to Senator Cherry's question—whether the TIO should ever deal with content complaints as such. And that would be an obvious issue when one had a converged regulator and converged legislation. The short answer to my own question is, no, I do not think the TIO should ever deal with content complaints, but we must be able to deal with content related complaints where the relationship is one of billing, credit management et cetera. So, in the long term, I expect ACMA to have an effect in relation to the TIO, just as in perhaps the shorter term I expect T3 to have an effect on us.

CHAIR—Thank you for your evidence this morning. It is very helpful to the committee. That concludes our questions for you.

[11.40 a.m.]

FEARON, Mr Paul Francis, Chief Executive, Essential Services Commission

CHAIR—I welcome you to the committee and thank you for your time today. It is much appreciated by the committee. You are here at our request. You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or deceiving evidence to the committee may constitute a contempt of the Senate. I invite you to make an opening statement before we move to questions.

Mr Fearon—The ESC is Victoria's independent economic regulator of energy, water and transport essential services. As the chief executive, I am head of staff; I report to a three-person commission which is charged with the responsibility of decision making under statute. I have been the CEO of the ESC for nearly two years, and this followed a career of 23 years with the electricity industry which included a period as energy adviser in the early 1990s to the Victorian government.

The ESC was established under its own act in 2002 to provide continued support for the Victorian government's micro-economic reform program and to ensure that the benefits of industry reform were passed on to household, commercial and industrial customers. Our primary objective is to protect the long-term interests of Victorian consumers with regard to the price, quality and reliability of essential services. Our act also provides a number of other facilitating objectives. These include financial viability of regulated industries; facilitating efficiency and the incentive for long-term investment; the prevention of misuse of monopoly or market power; and effective competition and market conduct in ensuring that users and consumers, including low-income or vulnerable customers, benefit from the gains of competition and efficiency. We seek to balance these objectives with regard to the setting of prices and standards, reporting on performance as well as undertaking inquiries, audits and reviews. We perform these functions via formal and informal consultation and through formal decision making by the commissioners.

The ESC is currently reviewing electricity distribution prices that will be charged for the period 2006 to 2010. This is a very significant review for the five monopoly electricity DBs—distribution businesses. The revenues of these businesses over the five-year regulatory period exceed $6 billion. The DBs are responsible for the majority of the quality and reliability of electricity supply that customers see. A reliable, safe electricity supply is obviously crucial to the growth of urban and regional economies across Victoria and the quality of life for its citizens. Poles and wires, which are what we are essentially regulating with distribution, account for about 40 per cent of a customer's total electricity bill.

Although reliability is being either maintained or improved across most areas of the state, including those that we call worst-served, there are a number of areas that are experiencing economic growth where the electricity infrastructure is not keeping up and there are a number of electricity feeders that are not delivering the minimum quality of electricity.

We are concerned to make sure that the regulatory arrangements include meaningful incentives for improving both short and long-term reliability, particularly in regional areas, and

that distributors are sufficiently held accountable for what they forecast to spend on reinforcement and asset replacement. We achieve this through a regulatory contract that exists for five years during which we allow the DBs to earn a level of revenue to run their businesses and meet a set of service levels and technical code obligations. We use a CPI minus X incentive regulation approach which allows the businesses to keep a share of the efficiencies they achieve and thereby reveal the ongoing efficient cost of distribution.

We regulate in three ways, Firstly, we have minimum obligations under various codes—for example, voltage levels. We issue a number of guidelines, for example, business customers and consumers who want to connect. Secondly, we have what we call targeted levels of average reliability, which we link to penalties and rewards and something we call GSLs, which are guaranteed service level payments, which are direct to the consumer if the service level falls below certain thresholds. Finally, we have transparent reporting of performance. In March this year we released a position paper, which is the precursor to our draft decision in June. In this paper we proposed the incentive regime for service reliability be extended to increase the penalties and incentives for performance and reduce the thresholds for payments to GSLs. For example, we are now intending to link reliability to the value of customer reliability, which for electricity is $30,000 per megawatt hour, and by comparison to the selling price of electricity, which is about $120 per megawatt hour, that value is 250 times more. So that is the incentive and penalty for excursions of reliability.

There are a number of payments that are made for interruptions during the year—and they escalate depending on how many interruptions a consumer gets—as well as penalties around call centre performance. Our experience has been that the combination of these S factors and GSLs, which have been in since 2001, has had a very positive impact in terms of improving average reliability and improving performance for worst-served customers and generally those who reside in either remote locations or heavily wooded ones. For completeness, I should say that the Victorian state government also provides a $110 million package to subsidise rural consumers.

Finally, it is worth pointing out that there are a number of significant differences between electricity and telecommunications. The electricity industry is characterised by a much clearer boundary between contestable activities—essentially generation and retailing—and the monopoly distribution network, which we regulate. The electricity distribution network is also characterised by slower rates of change with respect to supply technology—poles, wires and transformers—which does not change much, and the nature of customers' demand for services is not changing much. Basically it is transport of energy and the supply of electrical capacity.

The distribution production technology also exhibits the purest form of natural monopoly characteristics, with competition acting only at the margin, such as inset developments, bypass or embedded generation. It is conceivable that one day things such as fuel cells or hydrogen technologies will impact on the electricity distribution natural monopoly technology in the same way as fibre optics, wireless and digital have changed the face of telecommunications—although, as the public will have noted, there is a big comeback with the copper loop.

In light of production technologies, the public policy question whether to regulate electricity distribution is much clearer than it is with telecommunications, and for electricity distribution basically the potential inefficiencies and cost of regulation are more likely to be far outweighed by the benefits of permitting natural monopoly delivery and the avoidance of exercise of power.

The natural monopoly delivery also allows for a more accommodating approach to the averaging of network tariffs across regions and customer classes.

Finally, assuming that policy makers have determined that regulation is appropriate, that leaves the biggest question of how to regulate. On this question, telecommunications and energy regulation share the same challenges, namely, overcoming asymmetry of information and the problem of the efficiency-rent trade-off—which is probably a good point on which to finish my introduction.

CHAIR—I have one question that is generally about infrastructure. I notice that it is in your bailiwick of ensuring that the regulatory system has an appropriate impact on infrastructure investment. How do you monitor whether infrastructure investment is adequate, and how do you require providers to ensure infrastructure investment is adequate?

Mr Fearon—We have, first of all, a comprehensive auditing and performance monitoring framework. We send out technical auditors to see that the various codes and procedures are being complied with, we have performance reporting, and we put out a comprehensive performance report once a year, which is quite detailed. It goes to issues of performance down to individual feeder level and includes measuring minutes off supply, interruptions and a range of other service parameters.

CHAIR—Looking over the horizon in terms of future demand, how does that lead into a decision that more investment is needed here or there and that you are going to finger this or that person and say, 'You're going to do it'?

Mr Fearon—Ultimately, accountability for the delivery of infrastructure is probably the biggest challenge we have. In addition to the performance reporting, we need to rely on the incentives and rewards that I mentioned previously, which revolve around S factors and the payment of GSLs. Basically that means the business has quite a level of discretion within the period on how much it spends and where it spends, but at the end of the day if it does not deliver the performance it is going to get penalised. The history in electricity distribution is that, on average, there has been fairly consistent improvement in reliability. We have also seen a very significant improvement in what we call the worst-served customers. The fact that they have to pay a GSL if the number of outages is above a threshold or if the minutes off supply is above a threshold internalises the economic evaluation, if you like, and businesses put the investment in to avoid having to make explicit payments to customers. So that has been a very valuable mechanism to ensure that accountability.

Senator CONROY—I am interested in hearing about your experience with ring fencing in the Victorian gas and electricity sectors. This committee has heard a number of suggestions that Telstra's monopoly network business should be operationally separated from its retail business. The ACCC has suggested that ring-fencing arrangements in place in the gas sector should act as a model for such regulations. Can you give the committee a brief outline of the ring-fencing arrangements in place in the gas sector?

Mr Fearon—It might be a bit easier for me to talk about electricity because that is something we dealt with fairly comprehensively last year. We in fact put out a report, which I am happy to leave here. The ring fencing for electricity and, for that matter, for gas—and we are talking here

principally about distribution and retailing—has not been the issue that it has been with telecommunications. It comes back to the fact that the contestable activities in energy and the natural monopoly network elements are much more separable. In fact, even though the distribution businesses in Victoria that were privatised in 1995 were privatised as stapled retailer distribution businesses, the more dominant trend, which has been driven by the capital markets, has been to actually separate the network from the retailing. So the synergies obviously have not been that significant. Also, we have not seen substantial or even any real exercise of market power from the network into retailing. So it has not been an issue.

Nevertheless, we have put in place ring-fencing arrangements, which really goes to your question. The ring fencing is essentially the financial or accounting separation, with what I would call a relatively benign form of operational separation. That basically comes down to separation of staff, access of information and some limits on joint marketing. The reality is that there is not a strong internal driver to keep these two businesses together anyway. In fact, those businesses that have maintained both of those businesses have recognised that the value to their business is maximised by having them fairly separate in terms of the skills, attitudes and cultures that are required to run them both.

Senator CONROY—I am just referring to the section, 'Final decision: electricity ring fencing', on page 3 of your introduction. It says:

In March 2004 the commission released an electricity ring fencing draft decision and draft guideline. The commission considered and continues to consider that the current ring fencing arrangements under the national third party access code for natural gas pipeline systems of the national gas code are adequate and that additional ring fencing measures for the Victorian gas industry are not necessary at this time. The final decision is concerned therefore with only electricity ring fencing arrangements.

Could you take the committee through this national third party access code for natural gas pipeline systems or the national gas code?

Mr Fearon—My level of understanding is not particularly detailed on the gas side, but I understand that, in a similar way to electricity, there is a minimum requirement for separation between the businesses—the network businesses and the retailing side.

Senator CONROY—You have used the words 'minimum' and 'benign' so far.

Mr Fearon—Something that is not benign would be what I would call a legal separation that might also require people to be in different buildings and a very strict separation right through the senior management ranks.

Senator CONROY—I am just a little confused. The ACCC is championing gas ring fencing as a model. But what you have described seems a little less than what they have been talking about. I will just run through what the ACCC has been talking about. The two entities—wholesale and retail—would deal with each other on a commercial arms-length basis, including explicit pricing, invoicing and billing. Does that sound consistent with what the gas code does?

Mr Fearon—Yes.

Senator CONROY—It must maintain fully separate accounts and financial and non-financial reporting systems capable of capturing all transactions between the businesses.

Mr Fearon—Yes, that would be consistent with electricity too.

Senator CONROY—It must maintain separate staff at all levels.

Mr Fearon—The separate staff is also consistent.

Senator CONROY—A little earlier we had Professor Gerrand talk to us. He believed that making the two entities work in different buildings, for instance, would be a little unnecessary. But he did believe that a physical separation was necessary by, say, a PIN system and different floors for the different business units. Is that consistent with gas or electricity?

Mr Fearon—We do not go down to that level of detail. The presumption that we would make is that the guidelines provide for, if you like, in the spirit of things, a minimum threshold of separation.

Senator CONROY—How do you separate staff at all levels if they are not separated at least by floor? Are you suggesting that Chinese walls are working?

Mr Fearon—I suppose that, to be more specific, we would say that the staff are not the same staff providing the same services. But we would not be going in and auditing that.

Senator CONROY—So they could be sitting next to each other?

Mr Fearon—They could be sitting next to each other. As I said at the beginning, this is not a big issue in electricity or gas at the distribution retailing level. We acknowledge that it is possible that there are some synergies that are available to companies by being in both businesses. The issue is whether there is going to be the exercise of some market power that is going to be detrimental to competition. We have not seen any of that in any form since privatisation. In the very early days there were some issues of information sharing, but even that is not really an issue now. We have adopted a more light-handed approach to separation. We believe there is still a need to have separation for the time being. We would rely more on customers or businesses bringing to us cases, examples or situations where they believe there has been unreasonable discrimination, let us say. But, even there, we believe there is still a concept of efficient discrimination, if I can put it that way. Competition is not necessarily implying that there has to be a complete even-handedness of dealing in the energy sector. I acknowledge that in telecommunications there may well be a completely different set of drivers.

Senator CONROY—Is the gas sector legally separated?

Mr Fearon—In Victoria, the businesses were legally separated but sold in a stapled form. Since then, there have been a number of transactions which have essentially unstapled them. But there is no regulatory or legislative barrier to these companies being jointly owned. Basically, they were physically dealt with before they were privatised. So from the old gas and fuel corporation in Victoria the government created three stapled distributor retailers, and they were effectively operationally and physically separated prior to privatisation.

Senator CONROY—What did that legal separation consist of? I apologise if we are a little outside your area.

Mr Fearon—That is okay. From memory, they set them up as completely different legal entities and they had their own names—

Senator CONROY—Separate buildings, separate floors?

Mr Fearon—Initially they were the same, but pretty rapidly they were split up physically.

Senator CONROY—Was there much competition in the gas sector back when this legal separation was put in place?

Mr Fearon—In the early days only the market for large customers was opened up. Gas was subject to a lot more long-term contracts with bigger businesses, so you did not see quite the churn that you saw in electricity. There was very substantial churn in the electricity industry with major customers. Of course, since January 2002 we have had a mass market in electricity and gas. Anybody has the capacity to choose, and we have seen very substantial choice being exercised.

Senator CONROY—Why do you think that gas required legal separation but electricity, at least in Victoria, did not? What do you think was behind the thinking there? I am trying to get an understanding of the different models and what the different influences were that made those two decisions so different.

Mr Fearon—In the early 1990s—and I had some involvement in the public policy development then—there was a real question about whether the retailing function of electricity could actually be a stand-alone business that could operate—and indeed, ultimately, whether it could be sold—so the notion of stapling it to an asset basically carried the day.

Senator CONROY—With electricity there were a number of players in the generation and distribution markets, from recollection. But in gas, there was not. There was just the Gas and Fuel Corp.

Mr Fearon—No. With electricity, the SECV basically did all the generation, all the transmission and about 85 per cent of the local distribution.

Senator CONROY—I was a local Footscray councillor myself, and we had our own distribution.

Mr Fearon—Yes, prior to the SECV a number of the inner city councils ran their own electricity businesses. From memory, there were 11 municipal electrical undertakings.

Senator CONROY—We were one of them. The lack of legal separation of distribution and retail in the Victorian sector is inconsistent with the position of other states. In other states they did do the legal separation.

Mr Fearon—I am not sure that is correct. In New South Wales the electricity distributors were also the retailers, and the same in Queensland.

Senator CONROY—In the electricity sector do you impose the requirement that retail marketing employees and distribution employees operate independently and have separate work areas?

Mr Fearon—That is a matter of detail, but I think operational separation requires separate work areas, yes.

Senator CONROY—Why were those conditions imposed? Are you aware how they work in practice?

Mr Fearon—We are aware of how they work in practice. Observations and audits have noted that the natures of the functions are so different that they operate out of different offices. One is essentially a depot activity and the other is a call centre and trading operation. The way the industry has evolved has been to naturally separate anyway. The remaining concern is more around the potential access to information through IT systems—potentially, for example, being forewarned of when a customer may be intending to switch. Even that has not really been an issue, and there has not been any real complaint from competing retailers that a distributor has been favouring the in-house retailer, for example.

Senator CONROY—On that issue, how have you gone about ensuring that distributors do not provide retailers with preferential access to services such as customer connections, transfers and metering? This committee has heard evidence that the provision of equivalent services by Telstra is, to be polite, discriminatory. How have you dealt with that?

Mr Fearon—As I said, there really has not been any swelling of complaint or issue, so our approach has tended to be light-handed. The nature of the retailing and the nature of the distribution of electricity are so distinct that there really is not the possibility of easily undertaking that discrimination without creating significant internal inefficiencies. It is not an efficient outcome from a business point of view to even try and do that.

Senator CONROY—There are a couple of issues that are running in some of the arguments about telcos. I would like to get your opinion from your experience in the other sectors. The Minister for Communications, Information Technology and the Arts has often cited the Ofcom process—that is the British regulator—as a potential model for the operational separation of Telstra. In BT's response to Ofcom's proposal for operational separation it suggested that internal separation is sufficient to ring-fence its monopoly infrastructure. What sort of governance issues are raised by such an arrangement? Do you think just an internal separation would be workable?

Mr Fearon—I cannot really comment on how that would work in telecommunications, but, from my personal experience in electricity, apart from the fact that there are not the significant business drivers to take advantage of that the only other issue is that there are important internal cultural and, if you like, people issues that inevitably take hold when you apply some sort of separation. As soon as you start introducing management performance measures around a business unit's activity, in electricity we certainly found that very quickly the distribution people

become very focused on their line of business and the retailing people become very focused on their line of business. So that cultural effect was pretty strong. But that is electricity, I emphasise.

Senator CONROY—I am just looking to draw on your experiences for our debates on the telco sector. British Telecom also suggested that ring-fencing arrangements should only apply prospectively—that is, to new services but not to legacy services. If they tried that argument in the electricity or gas sector, what would you have said? After you stopped laughing, that is.

Mr Fearon—It comes down to how easily you can separate those activities. In electricity and gas it is conceptually possible to do that, but it is probably not something that was contemplated at the time.

Senator CONROY—They will try to sell you the Harbour Bridge next!

Senator TROETH—I have no questions. It has been very interesting.

CHAIR—Thank you very much for your evidence. I used to always think that the Office of the Regulator-General had the best name of any organisation in Australia, but unfortunately the government has seen fit to change your name. That is most unfortunate.

Mr Fearon—Yes. Dr Tamblyn, who, of course, was the chairman, always liked to say that he did have a uniform as part of the office!

Proceedings suspended from 12.13 p.m. to 1.24 p.m.

HORSLEY, Mr Allan, Acting Deputy Chairman, Australian Communications Authority

NEIL, Mr John, Acting Senior Executive Manager, Australian Communications Authority

CHAIR—Welcome. Thank you for your time today; it is much appreciated by the committee. We have received your submission and numbered it 24. Do you wish to make any amendments or additions to it?

Mr Horsley—No. The material stands as it is, other than mentioning that we have brought with us today an ACA publication outlining the way in which we manage spectrum allocation. We thought it might be of value to the committee.

CHAIR—We appreciate it. You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence may constitute a contempt of the Senate. I invite you to make an opening statement before we move to questions.

Mr Horsley—We are happy to move to questions.

CHAIR—Earlier today in his evidence, Mr Pinnock, the Telecommunications Industry Ombudsman, raised concerns about the enforceability of the consumer code. In particular, it was his view that a good 80-odd per cent of complaints that come to the TIO are referred by carriers. He is concerned that the provisions of the consumer complaints code are not being enforced, particularly the requirement of carriers to inform complainants of the right of redress to the Ombudsman. I am interested in your views on that and in what the ACA has done to ensure that a particular area of the code which I know has been of concern to the Ombudsman for some time is being enforced.

Mr Horsley—I will make two points first. The ACA monitors the processes that carriers have in place to ensure they are instructing their staff to provide the referrals that you refer to, because the codes require that the carrier must attempt to handle a complaint satisfactorily. If the customer is not satisfied with the way the complaint has been handled, they should be advised that they are able to take that complaint to the TIO. We look to see that those procedures are in place. If the TIO says to the ACA that it considers there to be a systemic problem, we would conduct an investigation into what might be perceived as a systemic problem with a particular carrier. We are not aware of any significant problem in referrals to the TIO, but obviously we are happy to take on board advice from the TIO and pursue it. Our view is that generally it works reasonably well.

CHAIR—On what do you base the assessment that it works reasonably well?

Mr Horsley—Largely on the fact that we have done a review of the processes that carriers have in place and we have reason to believe that they follow those processes. In addition, it does not feature as a high complaint package from the TIO—not compared with things like billing complaints. It has not featured as a major issue in the interchange between the TIO and us.

CHAIR—Just changing tack, I am interested in your views—I think we have had this discussion before—on infrastructure and the role of the ACA in promoting its roll-out. What contribution does the ACA make now to identifying future infrastructure needs in telecommunications and ensuring that carriers are delivering the necessary infrastructure?

Mr Horsley—Historically, the ACA had a role in overseeing the roll-out of the GSM mobile networks, where the government set policy targets for that roll-out to a certain percentage of coverage of the Australian population over a period of time. That is the major historic responsibility that the ACA has had. To the best of my knowledge, we do not supervise the roll-out of infrastructure per se. With the customer service guarantee, we are responsible for ensuring that people get standard telephone services on time and get them repaired on time. But in a policy sense, as you would appreciate, there are no regulatory requirements in place for the roll-out of any infrastructure other than the mobile infrastructure.

Mr Neil—I would add two points that may be of assistance. We recently oversaw the contract for the roll-out to improve services in extended zones, for which the government provided $150 million. Our primary role there was to monitor the contract for the roll-out, which included making sure they met the deadlines. Other issues to do with quality have arisen since in which we have become involved, but fundamentally we were involved in the roll-out. Under the government's response to the RTI, we are undertaking a role in monitoring the availability of services Australia-wide. So, in a sense, that will get us into the business of what infrastructure or services are available—mainly provided via infrastructure, obviously—in various parts of the country and reporting to the government on that in terms of future policy making.

CHAIR—That obviously touches on network reliability too, and the upgrading of exchanges and so forth?

Mr Neil—We have a separate regulatory requirement placed on Telstra in relation to network reliability: the network reliability framework which has been in place for two-and-a-bit years. That deals fundamentally with the numbers of repeat faults on the network and addresses the requirements on Telstra to remediate services that meet certain fault thresholds.

CHAIR—How is that process going at the moment?

Mr Neil—Again, following the RTI, that process has been subject to a review. Our conclusion is that the arrangements are, by and large, meeting their objective, which is to try and ensure that the worst parts of performance are addressed. It is a safety net requirement; it does not set standards for the performance of the network overall. It says that if a service gets to a certain level of performance something has to be done about it—and straightaway. That is what the requirement is on Telstra at level 3. We are having a further look at some other aspects of the network where you go a bit broader than the single-service level—the so-called level 3—to the level 2, which looks a bit more widely, and we are considering some possible changes to the framework to try and better target the activity at that level.

Mr Horsley—Senator Cherry, we made the point that in the two years that the project has been running we have seen a slow but progressive improvement in the reliability and the availability of the network. That situation is reported on monthly from field service areas and two-monthly from exchange service areas. You might recall also that to ensure that no individual

service performs poorly without being seen, level 3 monitors that circumstance. So we have seen some improvement. As Mr Neil said, we are trying to refine the package to improve the speed at which there is remediation in poorly performing areas.

Senator CONROY—The committee has heard some very surprising evidence about the operation of the telecommunications self-regulatory regime. How would you categorise the performance of the self-regulatory regime in protecting consumers from inappropriate conduct by telecommunications suppliers?

Mr Horsley—I think it could be said to be reasonable. As you appreciate, the Australian Communications Industry Forum develops codes of practice for the industry. Those codes have supply-side and demand-side contributions to their development. They are submitted to the ACA for registration. That has a two-fold effect: the ACA is then responsible for oversighting compliance with the code and it provides the TIO with a basis upon which to assess and decide upon individual complaints.

I would like to make two comments about the overall industry self-regulation process in the development of the codes. The first point is that it has been difficult and onerous for the demand side of the industry to contribute—and the ACA has gone out of its way in the last year to try and help that along, in conjunction with ACIF. The consumer contracts code, which was a very significant issue, coincidentally culminated today when we registered the code at a meeting this morning. So we now have a consumer contracts code in place. Credit should go to ACIF that that was developed with much more demand-side input compared with previous experiences. There is comfort that that has set a good framework and we will look to see new codes in place by November—because there is a six-month period to introduce the new codes.

The second point is that the process has probably taken a lot longer than many people would have liked. I think everybody agrees that the code development process has been a bit long. There is a certain effort, with both ACIF in the corporate sense and the supply and demand side, to try and speed that up and to be faster at producing the codes. That will address the issue of the extended commitment of resources as well as that of timely actions. Overall, I think it has been reasonable but there is always room for improvement, particularly in timeliness and demand-side resourcing.

Senator CONROY—What criteria do you apply when deciding whether to register a draft code submitted by ACIF? For instance, what process did you undertake in deciding whether to register the consumer contracts code that has just been registered today?

Mr Horsley—Perhaps the most important thing that we do is have ACA observers in the code development process. They are there primarily to ensure that what has been written to the code is capable of being administered. We do not directly input to the content of the code, but we do ensure that whatever is in the code can be understood and can be administered. The ACA, in registering the code, seek to ensure that the requirements of the act are met—that is, that appropriate levels of consultation have been undertaken. In a formal sense, we receive certificates from a number of people—the TIO, the ACCC, sometimes the Privacy Commissioner and always a demand-side person—which say that adequate consultation has been undertaken. Sometimes, post the registration, we will monitor how the code works. It is often the case that, given the experience of a year, the ACA might ask for that code to be

revisited and we might suggest that a number of issues need to be addressed in a review of the code.

Senator CONROY—So the formal process before you registered it today was that you sought informal monitoring along the way to make sure it was understandable and administrable, and you checked to make sure that consultation had been undertaken through the process of a couple of certificates.

Mr Horsley—Correct.

Senator CONROY—So there is a standard form of certificate asking, 'Have you been consulted?' Who would you ask whether they had been consulted? I think you mentioned a couple of organisations.

Mr Horsley—We get consumer certificates, which often come from the Consumers Telecommunications Network as the primary consumer player, from the TIO, from the ACCC and from the Privacy Commissioner.

Senator CONROY—Do they comment on whether or not they agree with what is in the code or do they simply say, 'We have been consulted about the code'?

Mr Horsley—On occasions they may have said, not to us but to ACIF when they were consulted in that process before it came to registration, that some things needed to be attended to. In the case of this code, the Privacy Commissioner required some enhancements to the code and the code went back to ACIF to take account of those requirements before it got to us.

Senator CONROY—So you actually have no formal role in determining whether the content is reasonable, useful, helpful or useless. You just get two certificates saying, 'You have been consulted and therefore it passes.'

Mr Horsley—No. We would, in fact, reject the code. We have no ability to modify the code but we can register it or we can reject it.

Senator CONROY—On what basis can you reject it? I was asking about what criteria you use and you basically said it is two certificates.

Mr Horsley—In the case of the contracts code, which is a good example, we asked for that code to be developed because prior to that there was only a guideline in place. So we asked for the code to be developed and to take account of a range of matters. If ACIF had decided not to address those matters and we thought those matters were significant, we could reject the code and we could send it back for enhancement. If they declined to enhance it then we could create a standard.

Senator CONROY—So if you are not happy you can create a standard instead.

Mr Horsley—Correct. So the last resort, if you like, is that, if we are unhappy with a code and reject it, we can create the standard.

Senator CONROY—In terms of enforcement, what would be the practical difference between you creating a standard and a code being registered? What does that actually mean?

Mr Horsley—With regard to enforcement, I think one would say they are similar but, because of the concept of industry self-regulation, we provide that opportunity first.

Senator CONROY—If, for instance, this contracts code had dealt with, say, three of the four issues that you had asked for—and I am making up the number four—and they would not address the fourth after you sent it back to them, you could say, 'We're not going to register that; we're going to introduce a code that deals with all four.'

Mr Horsley—Yes, we could have rejected it and asked for the code to be enhanced. If that were declined, given that we were determined, we would make a standard. I have to say that, in the case of the contracts code, that was in the air and we had made it clear without being threatening that we wanted the industry self-regulatory process to run but we saw the issue to be of such significance that we would consider making a standard.

Senator CONROY—Where you have obviously had someone monitoring along the way but have not had any predetermined position, if I could call it that—I do not want to be pejorative—where you have suggested that A, B,C and D be included, what criteria do you use to judge whether it is a good code?

Mr Horsley—We would come back to the question of whether the code is capable of being administered and perhaps the step before that would be to ask whether the contents of the code is capable of being understood and complied with by the industry. That is the first question. The second question is whether the code is sufficiently clear that we could administer it and, if necessary, conduct an investigation against the code and require compliance, with the next step of course being—

Senator CONROY—They are process questions. I am trying to get to the substantive content issue and how you determine the quality rather than those process type issues.

Mr Horsley—We would look at the code, judge it in an objective way and ask whether the content of the code practically achieves the objective which is set out in the code. The objectives are always in the front of the code. We would make those judgments. For consumer codes, we are particularly focused on whether they deliver an arrangement which is in the interests of end users, because that again is a requirement of the ACA.

Senator CONROY—Have you ever knocked back a code submitted for registration by ASIF on the basis that it did not adequately address an issue?

Mr Horsley—I seem to recall we have sent back a code asking for it to be improved, but we have never got to the stage of rejecting it to create a standard.

Senator CONROY—Just out of interest, do you remember what that code was?

Mr Horsley—No, I do not, but I can find out.

Senator CONROY—If you are able to, please let us know which code it was and in what way it was inadequate. What were the improvements that were made? That is as much for my own information as for the whole committee's. You did make mention of this, but I wanted to ask you: what do you think is a reasonable amount of time for a code to be developed?

Mr Horsley—My personal judgment is about nine months. In a previous life I was involved in the process. My view is that patience and tolerance runs out after something like six or seven months. I do not think you get much improvement after that. Given that the ACA need six weeks or so to register, a nine month window from start to registration is enough.

Senator CONROY—You must have been beside yourself—a real grumpy bear—about a five-year period for the contracts code. We went through some evidence in Sydney which showed that, from the time that it was first identified—and you were involved in part of that identification process originally—through to when it finally turned up on your doorstep, it was five years, so, based on your six to nine months patience running out, you must have been pulling your hair out.

Mr Horsley—Yes.

Senator CONROY—It is still all there, though!

Mr Horsley—Yes, some of it. That is exactly right. I think people's patience was seriously tested in the contracts code, and perhaps one of the benefits of that has been that there is now a commitment to do things much faster.

Senator CONROY—Have you got an informal nudge-nudge to the ACIF team that in nine months you are going to become a pretty grumpy bear?

Mr Horsley—Yes, we certainly do. We informally encourage ACIF. We use our staff who attend the meetings to encourage timely completion, and your point is probably to steel people to do things much better in the future. A new code process has just started on another code, and there is an across-the-board commitment that it will be done in a far more timely fashion.

Senator CONROY—In your view, what was the main contributor to the five-year period? Who was dragging their feet? Somebody must have been dragging their feet.

Mr Horsley—I think a range of people dragged their feet. Often people who go to these code committees are poorly briefed and are not empowered, and those two things cause endless delays. People will not commit at a meeting and want to refer back, and that process can frankly double the time. I suppose there are always examples of somebody using, if you like, the consensus environment of a code committee to game and to orchestrate delay. I do not think that falls into any particular group but I have seen it played out all too often.

Senator CONROY—The consumer groups were fairly vocal about this right at the beginning in some of their reports which I think you were involved in. Would you characterise them as being poorly briefed and not empowered to make a decision in this process?

Mr Horsley—My view is that consumer groups are underresourced and that may on occasion cause them to have to revisit things or take time to come to a position. Equally, I think, consumer groups struggle because there is no single entity, and so there is a need for them to in a sense harmonise a view.

Senator CONROY—But would you characterise their behaviour in this particular case—the five-year delay—as gaming the situation?

Mr Horsley—No. I think they were struggling to provide the same weight of input because in this particular—

Senator CONROY—It was a pretty authoritative report done by consumer groups that kicked off the whole process.

Mr Horsley—Yes, I agree. But in the process I think they perhaps struggled because of the strength of legal representatives or legally skilled people that were used by the supply side.

Senator CONROY—When you say supply side, that is the industry, isn't it?

Mr Horsley—The industry, yes.

Senator CONROY—Who else goes? Consumer groups, industry groups and obviously the ACIF people—is anyone else there?

Mr Horsley—Us, the ACCC and the TIO as observers.

Senator CONROY—So, if it were not the consumer groups that were gaming to slow the process down, that would lead, by a process of elimination, to you. No?

Mr Horsley—No.

Senator CONROY—Industry?

Mr Horsley—I think there are often competing issues with industry, and so there are delays that are caused because people are uncomfortable with predicted outcomes.

Senator CONROY—You described this process as being slowed down by a bit of gaming.

Mr Horsley—Yes.

Senator CONROY—Presumably, the consumers were not gaming, so that does leave only the industry.

Mr Horsley—Yes.

Senator CONROY—How would you characterise the overall level of compliance with ACIF codes by carriers?

Mr Horsley—Overall, I think reasonable. We have found instances where some carriers have been slow to comply with codes. We would also say that, where the ACA has had reason to meet with a carrier to investigate compliance and when issues are raised with them, the response to comply has been pretty reasonable.

Senator CONROY—Is there any area in particular that you can identify at the moment where there are some weaknesses in compliance?

Mr Horsley—I suppose if there was an area of weakness it would be the ability of the carrier to ensure that their breadth of staff at the coalface, and the coalface is often quite large, is well informed and complying with the code. When we go and meet with the management, if you like, or the regulatory teams in carriers, we find very sophisticated compliance regimes in place. A genuine process is to try and ensure compliance. Often you see at the coalface instances of poor compliance. They can be shortages of training or perhaps not as good management at the coalface, but by and large I think they make positive efforts to comply. As an example, you might be aware that the ACA became very concerned about Vodafone's perceived failure to comply with the mobile number portability code. We went to Vodafone and sought some compliance. That did not come as fast as we would have liked and we issued a direction. After a period of some months, which involved some substantial software changes as a consequence of the software upgrade, we now have compliance.

Senator CONROY—You registered the consumer contracts code today. Is it enforceable from today or after a 12-month period?

Mr Horsley—No, a six-month period.

Senator CONROY—So industry now has six months to comply with the code.

Mr Horsley—Correct.

Senator CONROY—I am aware that at least one major carrier has already completely redrafted its contracts arising out of the Victorian government legislation. Are you aware of other companies who are working to redraft theirs to comply?

Mr Horsley—Yes.

Senator CONROY—Is everyone giving an indication they are willing to go down this path?

Mr Horsley—They are, yes. Let me say, we will be working with the carriers in the next six months to ensure that, come D-day, we have compliance. We are making it abundantly clear that, for the reasons that you outlined—the time taken—we will expect compliance when the code kicks in.

Senator CONROY—Given what you described earlier as some of the industry gaming, is there six months to comply and then a further six months where they can go into a sort of argument, dispute or whatever?

Mr Horsley—You might be aware that we funded the Communications Law Centre in Sydney to review existing codes so that we had an independent assessment as well as our own that the codes were not very good, that they were clearly unfair. We would expect, given the understanding of the significance of this code across the industry, all of the carriers to be complying by the end of the six-month introductory period, and we will be proactive.

Senator CONROY—Will you be naming those that are not complying after six months, given the amount of notice?

Mr Horsley—Absolutely.

Senator CONROY—I think you may be alluding to this—there have been a number of areas in which the ACA has identified systemic disregard for registered codes. There is an example with respect to the IPND code.

Mr Horsley—Yes.

Senator CONROY—What action does the ACA take when it becomes aware of systemic issues like this?

Mr Horsley—It would conduct an investigation to confirm that there was noncompliance. It would in the first instance negotiate with the individual or the company to comply and, if the company did not comply, we would issue a direction. That was what we went through in the mobile number portability case.

Senator CONROY—Is there no thought of prosecutions, or is there a prosecution after a direction is not followed?

Mr Horsley—Correct.

Senator CONROY—Has no-one ever defied a direction?

Mr Horsley—There is an individual in Perth who has defied a direction, and we have taken court action. That was a breach of the act with regard to publishing a reverse directory. There is also a spam prosecution.

Senator CONROY—Do you believe there is some deterrent value in pursuing breaches of the law?

Mr Horsley—Yes.

Senator CONROY—If the ACA becomes aware of a breach of a registered code, what do you do next?

Mr Horsley—As I said, we would conduct an investigation to confirm the extent of the breach and we would then in writing request the carrier to remediate their behaviour to eliminate the breach in compliance. If that did not work, we would issue a formal direction.

Senator CONROY—Is there any recompense for those who have been a victim of noncompliance?

Mr Horsley—As I understand it, that is not within our power.

Senator CONROY—ACIF have told us that the ACA has never taken enforcement action against any company for noncompliance with a registered ACIF code. Is that correct?

Mr Horsley—No, it is not correct. We have taken formal enforcement action in the case of Vodafone and mobile number portability. That was a formal action of the ACA, a formal direction to comply.

Senator CONROY—This is always a bit of a leading question, but do you have enough resources?

Mr Horsley—I think so.

Senator CONROY—Are you satisfied that the laws are adequate at the moment to handle the growing issues that you are faced with?

Mr Horsley—Yes. We do not propose any legislative amendments. We find that the range of powers that we have are reasonable.

Senator CONROY—Has the ACA ever engaged in enforcement action against Telstra with respect to a breach of a licence condition?

Mr Horsley—I do not think so. I think we have often sought compliance from Telstra, but we have not engaged in formal enforcement. Sorry—over mobile phone towers, we did issue a formal direction to Telstra and Hutchison to comply with the code that covers communication with the community on low-impact facilities for mobile phone towers.

Senator CONROY—Do you regularly audit Telstra's compliance with its licence conditions?

Mr Horsley—I do not know that we regularly audit it, but we monitor it.

Senator CONROY—Do not be nervous, but I know about eight Telstra witnesses are sitting behind you.

Mr Horsley—You shouldn't have told me!

Senator CONROY—Those questions were just to let them know I am here.

CHAIR—Thank you very much for your evidence today; it was very helpful. Good luck with the merger.

[1.58 p.m.]

LANDRIGAN, Dr Mitchell, Group Manager, Regulatory, Telstra Corporate Office, Telstra

SCALES, Mr Bill, Group Managing Director, Corporate and Human Relations, Telstra Corporate Office, Telstra

CHAIR—Welcome. Thank you very much for your time today. It is much appreciated by the committee. We have received your submission, which is numbered 25. Do you wish to make any amendments or additions to your submission at this stage?

Mr Scales—No, not to the submission. We do have a short opening statement.

CHAIR—You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I now invite you to make that opening statement before we move to questions.

Mr Scales—Thank you very much for giving us the opportunity to be here today. We welcome that and we welcome the opportunity to make a few opening comments. As you appropriately mentioned at the beginning, we have given you a reasonably extensive submission so I will not go into all of that, but there are a couple of things that I want to say before we start. The first point we would make is that we think—and this comes through in our submission—that there are some elements of the 1997 regime which we think are now outdated. We would argue that, in fact, further deregulation is now required if we are to have the sort efficiencies that should come through from a viable and very dynamic telecommunications sector. We think it is therefore very important to revisit the regulatory framework, and we thank you for being prepared to do so.

Much of the current regulatory regime was drafted almost a decade ago. It was implemented in order to effect the transition from a monopoly-duopoly to competition. The intention, of course, as we all know, was that regulation would be reduced as competition developed. Unsurprisingly, as markets have matured and competition has intensified, many elements of the 1997 regime have really become outdated. Some of the regulatory measures were only ever intended as short-term measures while competition developed. A notable example of that—and we give quite a bit of detail of this in our submission—is part XIB of the Trade Practices Act. Part XIB, as you know, is primarily related to effectively addressing the abuse of market power and was really only aimed at Telstra. I do not think there is any other company in the country that has the same provision associated with it. But it was only ever intended as a transitional regulatory measure.

The Productivity Commission, as you probably are aware, looked at this a number of times. In one of its draft reports, going back to 2001, it toyed with the idea of getting rid of that provision completely. In its final report—as you know, it does draft and final reports—it moved away from that but, very importantly, it said that it needed to be reviewed again in the not too distant future. In some ways this committee's deliberations are quite opportune because it does give an

opportunity for you to at least look at whether part XIB of the Trade Practices Act should be repealed or at least changed.

The second point we wanted to make is that the Australian telecommunications market is now highly competitive. We have been monitoring many of the submissions that have been put to you. You would be surprised, if you looked at only those submissions, to think that we actually do have a highly competitive telecommunications market because that does not come through in many of the submissions you have. We have tried to set out in our overview the level of competition. Suffice to say that there is evidence of substantial entries and significant reductions in Telstra's market share for all services across the board, including price declines and high levels of customer churn. We think these provide potent testimony that Telstra faces significant and sustainable competition for all of its services.

The dynamic nature of the telecommunications market and the emergence of new technologies have further intensified the competitive pressure on Telstra. You would be aware of them because you have seen many of them come before you, but there are now over 150 licensed carriers in the market competing with Telstra. Many of these competitors are vertically integrated and they are also horizontally integrated. There are many affiliates of powerful foreign owned and even foreign government owned corporate multinationals. Some of them with whom we are competing today are actually larger than Telstra. These affiliates can draw on the extensive resources of those multinational entities when competing in the Australian market, and they do.

The third point we wanted to make is that we think there ought to be emphasis on deregulation rather than increased regulation. We would be very concerned if this inquiry were to recommend an increase in the level of regulation across the Australian telecommunications sector. We think that the telecommunications sector is already one of the most heavily regulated sectors in Australia. Overregulation in some areas of the telecommunications industry is now, we think, distorting effective investment. It is imposing additional costs and leading to quite significant confusion for consumers and the industry. We think existing regulation should be rationalised with a view to ensuring consistency, symmetry and certainty. It is also important that it is telecommunications deregulation, rather than regulation, which has principally facilitated market entry and the development of competition with that efficiency. We are very happy to take any questions you might have of us.

CHAIR—You indicate in your submission that part XIB of the Trade Practices Act is no longer needed in that it is a transitory provision. What is Telstra's suggestion for an appropriate regulatory arrangement to replace that part?

Mr Scales—I will ask Dr Landrigan to talk about that in some detail, but the general point we are trying to make throughout our submission is that we are now at the point in history where Telstra and the telecommunications industry in general should rely on general provisions of the Trade Practices Act. It is worth saying right at the beginning that we are not arguing for no regulation—far from it. We understand that all industries should be appropriately regulated. A robust debate is going on now about what is the appropriate level of regulation, not only in telecommunications but also in other industries.

We do not shy away from that and we do not shy away from the fact that most industries require some form of regulation to give the community the certainty that they are looking for about being fairly treated, to be sure that there is no abuse of market power, that organisations are not abusing consumer rights and so on. We are not saying no regulation; we are saying that now is the time to consider simply normalising that regulation so that the telecommunications industry comes under the general provisions of the Trade Practices Act rather than the quite specific ones. We think part XIB falls pretty well into that category.

Dr Landrigan—I think Mr Scales has summarised it quite neatly. Our position quite consistently for a number of years has been that the measures within part IV of the Trade Practices Act are, and have been demonstrably shown to be, sufficient to regulate the telecommunications sector and that the powers within part XIB are not necessary, which, as has been pointed out, was the original Productivity Commission draft finding in 2001.

CHAIR—I would have thought, given the various High Court cases, that part IV has been found to be pretty inadequate in dealing with any part of the economy in Australia. I was wondering if Telstra has any views on the various recommendations of the Senate committee suggesting that the enforcement powers in the Trade Practices Act generally need to be improved by looking at issues like divestiture, cease and desist powers and so forth.

Dr Landrigan—We have taken a very keen interest in some of those inquiries and certainly in the findings from them. Turning to the cease and desist power—which I know is a topic that has been raised as part of this inquiry and has been raised for a number of years—I think it has been pointed out quite a few times that the cease and desist power raises some complex constitutional questions about the intermingling of judicial and executive powers by the regulator. So that is not an easy topic to deal with just by way of strict legislative reform. I would point out that as part of the Dawson recommendations there is going to be quite significant bolstering of the penalty provisions in part IV. I would have thought that for those who are concerned about the administration of part IV that would be quite a welcome thing.

Most of the debate around section 46, which you may be alluding to and which has been the subject of quite a few High Court decisions recently, has not been carried out in a way that raises concerns about part XIB. The debate has really been around the taking advantage component of section 46 rather than about purpose or effect. I am not sure, with respect, what relevance those High Court decisions have for part XIB.

CHAIR—I was wondering, in arguing for bringing telecommunications under the general provisions of part IV, what the view of Telstra was in that broader debate about what should be in part IV and the enforcement of part IV, in particular coming back to divestiture powers.

Dr Landrigan—Divestiture is clearly a complicated issue and much of the debate has not been about strict divestiture of entities as they currently exist but about incremental power that has effectively resulted as an accretion of market power or through creeping acquisitions. To my knowledge there has not been detailed debate about divestiture per se of an entity in its existing form. But on my understanding that has been a relatively small part of that debate. Much of it has been around purpose and effect. I think the current position about that debate is that it is quite redundant given that most of the High Court decisions in which concerns have been raised about whether section 46 has worked have not been about purpose. Purpose has generally been

either conceded or quite easily proven, largely because of provisions that are built into section 46. The taking advantage of market power component has been the subject of some detailed debate with some measures proposed about whether certain indicia about what market power is should be built into the legislation.

CHAIR—You also indicate in your submission a concern that the regulatory system is impeding Telstra's capacity to invest in additional infrastructure. From a regulatory point of view, what do you see as specific aspects of regulation that are impeding Telstra's capacity to invest in new infrastructure in Australia?

Mr Scales—I think there are two elements. While we address the specific issues around part XIC, which you would be aware of—I will come to that in a minute; Mitchell and I can share some of the issues here—we are also saying that it is implicitly part XIB for Telstra, although this will not necessarily be true of all sectors or businesses. Both of these tend to affect our ability to understand the risk profile of any investment going forward. There are a couple of elements of that. Take part XIB for a start. The way that is currently administered gives us a significant amount of uncertainty about what might be the actions taken by a regulator—in this case the ACCC—when we take any action to operate what we would regard as relatively normal in the marketplace. The most recent Big Pond competition notice was a very good example of that. From our perspective, we saw ourselves operating simply to meet the competition. There is no doubt that throughout that whole period we became risk averse in making what would have been normal business investment decisions. While it will not show up in any statistic, I can tell you without doubt that that affected the way by which Telstra thought about some of its investments over that whole period. Simply the operation on a day-to-day basis of that particular section of the act is an impediment to the way we think about ongoing investment and the level of investment.

Secondly, when we think about part XIC, we get into a much broader debate and discussion, where, as you know, it is primarily around how access arrangements apply—what are the appropriate means by which people can obtain access, what are the guarantees that need to be given by Telstra when people are seeking access, the price of access and so on. What we are concerned about is the uncertainty that currently applies. When it comes to particularly large amounts of investment in areas, it would not necessarily fall under the category of having natural monopoly characteristics. It is in those two general areas that we think there are, from a day-to-day perspective, significant impediments.

CHAIR—I am interested in your comments about the Foxtel digitalisation case study and the overturning of the exemption on appeal, what impact that has had on the roll-out. Where is the roll-out of digitalisation up to now? Has it occurred?

Mr Scales—It is in the process, like all of these investments, and that is another element of the uncertainty. Telecommunications is not like building a factory where you decide to spend some money, the factory is built and then you move on to the next issue. You make an investment over a long period and digitisation, as has been discussed, with fibre roll-out and things like that are investments made over sometimes a five- or 10-year period. That is another element of the uncertainty that creeps into this. To answer your question specifically: the point we were trying to highlight in our submission is the layers of uncertainty that apply when companies like Telstra think about an investment.

In this case, we had a situation where we knowingly and wittingly entered into a discussion with the ACCC. For all intents and purposes we felt we had an agreement. Admittedly over an extended period of time the debate went on between ourselves and the ACCC. We felt we could make some investments understanding the regulatory environment which we were dealing with, only to find in due course the decision overturned on appeal. Then when executives like me and others are trying to put something before the board where often we are talking about billions of dollars of investment, what do we say? Do we say, 'Don't do it until such time as you have everything ticked off'? If you do that, the net effect might be that you miss the opportunity to get first-mover advantage, as most organisations will try to do. If you do not do it, you are really asking the board to take a much bigger risk than they would otherwise take and by implication the board will often say, 'If we are going to take a bigger risk, we should look for a greater return.' So there is a whole range of issues around this that we tried to build into the submission, to suggest to you that regulation and the way in which it is used is not a free good. The community pays in one form or another, if it is not appropriately structured and administered, and that is what we tried to allude to in the example we gave.

CHAIR—We have received some correspondence from you, which the committee will deal with in private at another time. But I am interested in your general response to the submission from the GSM Gateway Association that you would have looked at, in particular the extent to which you believe that the reselling of mobile services is a legitimate business or an illegitimate business.

Mr Scales—There are clearly two separate issues that we are dealing with here. We are not arguing that it is an illegitimate business—if you want me to, I can go into our submission to the committee—but of course the claim that was made against us, as you know, was that somehow we were trying to influence a witness.

CHAIR—I do not want to go into that matter at this stage. I am interested in the broader issue of whether Telstra has been turning off the services of people who have been reselling access to mobiles.

Mr Scales—There are laws that apply in terms of the way in which any reseller operates, and we do not have any control over that. That is the law. We have dealt with those people in a normal commercial way. We are not arguing that the business per se is a business that we would not deal with. I am hoping that that came through in the response which we sent to you. It is implicit in the commentary that that is the case. That company, in particular, owes us some money and we are looking for that money to be repaid. What is implicit in that is that it is a legitimate business that we would deal with. But we are always concerned to make sure that not only we but also the people whom we deal with, firstly, operate within the law—and I am not suggesting that they did not, by the way—and, secondly, they live within the terms and conditions of the contract between us.

CHAIR—One suggestion that was put up was that Telstra unilaterally changes the terms of contracts with its customers part way through the life of a contract to render some of those businesses no longer viable.

Mr Scales—The question of whether any part of a contract can be changed is determined by the contract. If a contract says that certain terms and conditions can be changed then both parties

will enter into that knowingly. Therefore, if elements of it can be changed and if we believe that it is appropriate that they should be changed, that is what will happen. For example, if we enter into a contract with a commercial organisation and, as part of that contract, certain costs increase, exchange rates increase—and that has a big bearing on the value of that contract—and we are entitled under the contract to try to renegotiate that, we will do so. But that is a normal part of the way in which we do business on an ongoing basis.

Senator TROETH—I have one question. Harking back to your immediate need to consider investment decisions, I am looking at the comments that you made in your submission about a complete upgrade of the existing copper network. Given that that is emblematic of some of the things you will have to look at in the future, apart from the abolition of part XIB and what you said about wishing to take up section 4 of the Trade Practices Act, what other general changes would you want to make to the regulatory regime in order for you to contemplate some of those major investment decisions?

Mr Scales—In our submission we were not suggesting that we would not continue to invest in our copper network. We are doing that all the time.

Senator TROETH—No, I did not mean that. But you would obviously like a framework which would be conducive to taking those investment decisions with confidence.

Mr Scales—Yes. Go to the very last page of our submission. You do not need to rely on us. All we are saying, quite frankly, is that, if you rely on the Productivity Commission, if the government were of a mind to apply those rules to telecommunications, that is all we are looking for.

Senator TROETH—This is from 2001.

Mr Scales—Yes. I do hasten to add that we were not looking for any special arrangement for Telstra. What we were saying was that that seemed to us to encapsulate the sorts of things which would enable Telstra and other organisations like Telstra to be able to invest with some certainty. We were not wanting to create our own. We thought that was quite a sensible blueprint.

Senator CONROY—Over the course of the inquiry we have heard quite a lot of evidence from many of Telstra's competitors. I am sure you have had a few people following the inquiry and keeping you briefed, and not just on the one matter you have just been discussing. They have made a number of comments about what they view as anticompetitive behaviour and conduct on Telstra's part. I would like to give you a chance to respond to some of the claims that we have heard today. We have heard a number of claims from regional ISPs that Telstra has been using the federal government's HiBIS subsidy to gazump the roll-out of broadband infrastructure in regional areas. These ISPs have claimed that Telstra is targeting its DSLAM roll-out at areas where regional ISPs have recently installed broadband infrastructure. A recent case that gained some publicity was a situation where two young students installed wireless broadband infrastructure only to be gazumped by Telstra very shortly after completing the bills. Does the presence of an infrastructure competitor influence Telstra's decision to roll out infrastructure in that area?

Mr Scales—No, it does not. But, again, there is cause and effect here. In some ways it is not surprising that companies like us will look for where there is likely to be increased demand and that we will all go into that area roughly at the same time. So there is nothing surprising about people trying to anticipate where demand is and accommodating it. The thing that drives us more than anything else, particularly in areas where there is not an obvious demand for something like broadband, is our broadband register—as you know, and we have had a number of discussions around that in other forums. That tends to be the thing that drives us most these days. It is quite interesting. You could imagine, again, a sort of cause and effect. You could see a situation where people register on the broadband register at the same time other people in other sectors of the industry are saying, 'It looks like there's a demand.' Then they go in and we go in at roughly the same time. But certainly we are not influenced at all by whether a competitor is going in. What we are doing is chasing customers where we can observe them.

Senator CONROY—In the past you have described this type of conduct as just responding to competition.

Mr Scales—It is actually responding to customer demand.

Senator CONROY—What studies do you think these two young students undertook to satisfy themselves that there was demand before they installed wireless broadband infrastructure?

Mr Scales—I do not think they would need to do any studies. That is the nature of entrepreneurship.

Senator CONROY—So why didn't Telstra notice the same hole?

Mr Scales—We did. We do. We are all of the time looking for where they are.

Senator CONROY—Two uni students picked it before Telstra.

Mr Scales—No, my point is slightly different. My point is that different organisations use different methods to determine where demand is.

Senator CONROY—But two kids just guessed where it was, and Telstra did not notice.

Mr Scales—They offered it. That is one of the wonderful things about entrepreneurship. It happens to be true. That is the way entrepreneurs work.

Senator CONROY—They just took a guess.

Mr Scales—To take another example, with crikey.com, I am not sure that—

Senator CONROY—You get mentioned in that nowadays more than I do.

Mr Scales—That is exactly right. But I am not sure that he determined—

CHAIR—I do not think he determines subscription!

Mr Scales—I am not sure he would have done many studies before he established the facility.

Senator CONROY—He could not get a job anywhere!

Mr Scales—But it has turned out to be quite an entrepreneurial activity.

Senator CONROY—If his subscriber base holds up.

Mr Scales—But if you take us as an example of those sorts of online activities it is true that what Telstra will do is go through a fairly laborious process, doing surveys. We report to a board. The board will ask us, 'What is the return?' They will ask us where the revenues are. They will ask us what—

Senator CONROY—They have reached DSLAM. The board asks you for the return on—

Mr Scales—No, not quite, but you understand the point I am making.

Senator CONROY—Very bored on the board—very boring board meetings! Take me through that process of how you determine where to install broadband infrastructure.

Mr Scales—There are a number of processes by which we do that, but in areas where there is obviously marginal demand then we use the broadband register as our main indicator. But if you take an example where there is a new residential development of 2,000 or 3,000 homes then there is a different process to follow. That follows the normal planning processes. So inside the company we have a number of means of doing that. If you also take the broad Telstra Country Wide approach of having people on the ground watching what is going on, you get a sense of where there might even be changes in tastes and preferences in particular areas of rural and regional Australia.

Senator CONROY—I have been to a whole range of areas, as I am sure you are tracking. One of our recent excursions was to Dubbo, where they seemed to be screaming very loudly for increased services. Some of them were from slightly outside the Dubbo area, so I should state that what they were complaining about was the CDMA satellites, which is not something that directly goes to what I am talking about. I go into areas like Townsville and Dubbo—and Wodonga yesterday—and people are crying out for broadband. How do they get onto this broadband register? It sounds like it is a bit hard to get onto.

Mr Scales—Again, we have been through this in a number of other fields.

Senator CONROY—Do you advertise—for example, 'Apply to get on the broadband register'?

Mr Scales—Yes. People know about it. It is on the web site. People know how to apply for it.

Senator CONROY—I do not. Tell me about it. I am new to the portfolio, though!

Mr Scales—You would be surprised how people developed small lobby groups to encourage others—

Senator CONROY—That is what I keep encountering—these lobby groups being formed around the country. It seems strange that, if there are all these people alert to what is going on and you are doing all these surveys, all of a sudden these lobby groups bob up and you have not noticed them.

Mr Scales—No, it would not be surprising at all. What you are encountering is what you would encounter in areas where there is marginal demand. You are encountering areas where you might get somewhere between 50 and 100 people in that particular area.

Senator CONROY—What level of demand do you need before you would say, 'Okay, this is an area where we've got to put at least a DSLAM in or look at what is appropriate'?

Mr Scales—It varies, but—for the sake of the debate and the discussion—it can be between 80 and 100 customers. To take the other part of your question, which was around HiBIS, that is why the government has reduced that break-even point by subsidising the application of broadband by making subsidies available to companies who are eligible to receive them, so that that break-even point can be lowered. In that circumstance the figure can be somewhere between even 20 and 50.

Senator CONROY—To introduce a bit of a sideline, an answer to some Senate estimates questions indicated that something like half the money that is coming from HiBIS is going to satellite. Does that surprise you?

Mr Scales—No. I cannot verify that that is the right figure—if you wish, I can come back to you on that.

Senator CONROY—I think that is right: 53 per cent.

Mr Scales—Rather than talk about the specifics of that, it would not surprise me, given the point that I made earlier, that you are now talking about areas where it is very marginal in terms of the economics of taking any facility, in those cases, out into those areas.

Senator CONROY—As I said, I have been to some of these areas now, and there are deeply unhappy people very much wishing they could go back to dial-up, with the satellite. That is not a reflection on Telstra. It is just that it seems that half the money we are spending on HiBIS is actually on a bandaid solution that ultimately does not deliver what people are seeking. I appreciate that these are very remote areas that would not come close to the 80 to 100.

Mr Scales—I think what you are raising there is an issue—

Senator CONROY—Yes, I said it was a slight sideline to what we are talking about.

Mr Scales—It is, but it is an important point because you are raising questions about changes in technology. You are seeing right now the development of different technologies to meet different needs. You are seeing one-way and two-way satellite capabilities. It is true that some customers would prefer to have two-way satellite, but that is dearer. With one-way, you get very fast downloads but not necessarily uploads. Over time, technology will change and it will become cheaper, and there will be opportunities for some of those technologies to more

adequately cope with those parts of rural and regional Australia. So it is not surprising that you would encounter that. The further you go out into remote Australia the more you will encounter those commentaries, as we do. In Aboriginal and Islander settlements, you will find it even more so and you will find, not surprisingly, that the technological solutions become more complex and dear. Therefore, by implication to some extent, only a company like Telstra would eventually find itself in that area, because others will not want to go there.

Senator CONROY—I was interested in your thoughts on that. You say somewhere between 80 and 100. Would that be metropolitan?

Mr Scales—Metropolitan is not the issue here.

Senator CONROY—There are plenty of suburban areas that I encounter that would like faster access to broadband.

Mr Scales—That could be the case, but it would be quite unusual. That is not generally the case. We are generally talking about rural or remote areas, although that may be the case in some parts of urban Australia.

Senator CONROY—Not everybody has a broadband connection at the moment.

Mr Scales—Yes, but that does not necessarily mean that they do not have a provision exchange.

Senator CONROY—I am trying to understand that process.

Mr Scales—The provisioning of our exchanges in urban Australia is sufficient to cover around 90 per cent of households.

Senator CONROY—So someone would simply have to ask you? They do not need to collect 80 to 100?

Mr Scales—No. Again, we are moving into a slightly different set of issues, because there are more than one means by which you can deliver broadband. Clearly what you are describing is the delivery of broadband primarily over our copper network. When we deliver broadband over our copper network, particularly through what is described as ADSL, there are technical limits—you can do it at a certain distance from the exchange. For example, in parts of Sydney where, on the face of it, it is a short distance as the crow flies, it can be quite a long distance because you go up and down hills and around dales.

Senator CONROY—How does a person in that circumstance get ADSL?

Mr Scales—They register for it.

Senator CONROY—They are told it is too far away from the exchange: 'We really have to put a new exchange in.'

Mr Scales—That is exactly right. We do that all the time. We try to understand where the level of demand is, where we should put a new exchange, whether to put mini-exchanges into the network or close to the road and so on. That sort of planning is going on all of the time as the demand changes.

Senator CONROY—To get a new exchange built closer, does the broadband register work the same way in that you have to round up 80 to 100? It is probably a bit more expensive than just a DSLAM.

Mr Scales—A new exchange is a slightly different issue. Gungahlin is an example of how that operates—when a whole area is being developed, you build a new exchange and you provision that exchange.

Senator CONROY—It is easy where there is a new area, but what would they need to do in a pre-existing area in Sydney that is outside the five kilometres?

Mr Scales—In most cases those customers are close to an exchange. It might be that that particular exchange is not provisioned, so we would provision that exchange.

Senator CONROY—You have been trialling ADSL 2 or 2 Plus?

Mr Scales—ADSL 2 and 2 Plus.

Senator CONROY—Are you ready for roll-out yet? If it is commercial-in-confidence, I understand.

Mr Scales—We are still trialling both of those technologies.

Senator CONROY—What will be the process? How do I get on the ADSL 2 Plus register?

Mr Scales—It will be driven primarily by demand.

Senator CONROY—The same sort of process? I can look for an ad in the paper?

Mr Scales—Just ring. I can give you the telephone number and you can ring Telstra. We would be very happy to have you as a customer.

Senator CONROY—We have also heard a number of complaints about Telstra's charging practices in relation to transferring broadband customers from Telstra DSLAMs to competitor DSLAMs. We have been told that this process involves simply moving a cable from one socket to another, yet Telstra charges $90 a pop for it. Does that sound right?

Mr Scales—Why there is a charge?

Senator CONROY—For moving a cable from one socket to the next?

Mr Scales—It is not as simple as that. I am sure that they were not—

Senator CONROY—They were suggesting that it was a matter of unplugging a cable out of one socket and plugging it into another. That is basically what they told us.

Mr Scales—It is a bit more complicated than that. The provisioning of exchanges is required.

Senator CONROY—What do you mean by 'provisioning of exchanges'?

Mr Scales—Provisioning of the exchange to enable the transfer of the service from Telstra to another wholesale customer.

Senator CONROY—Let us say there are two DSLAMs—yours and somebody else's. So it is already there. Would it already be provisioned in that case?

Mr Scales—It may not be already there.

Senator CONROY—This is different from putting in one. I accept that that is slightly different—space has to be rented. As Alan Kohler said, you are really just a real estate agency. His article is fascinating. If it was already there and it was just—

Mr Scales—The problem about managing these sorts of examples is that I do not know whether they are exactly as you have described them or not.

Senator CONROY—Or an exaggeration.

Mr Scales—Or an exaggeration. So it is very difficult. When our wholesale business looks at these issues and negotiates with our wholesale customers, there are a range of prices for the delivery of certain services. They range from the complete provisioning, which is the establishing of a DSLAM and doing all of the work associated with that, where we are virtually providing the whole service for a wholesale customer so that to all intents and purposes they become a reseller of our business. Then we go right the way through to where some of our wholesale customers buy their own DSLAMs and do their own work, and all we do is the sorts of things that you might be describing here—relatively simple services—and each of them has a different cost.

Senator CONROY—Can the committee get an indicative cost? We are happy to take that in camera.

Mr Scales—Let me take that on notice.

Senator CONROY—I want to know whether we can ascertain whether what you are charging is what it costs you.

Mr Scales—That is a matter that of course we are always in discussion with the ACCC about. I do not make that point flippantly. It is part of the access regime, which has a number of characteristics to it. There is simply the ongoing cost of access and then there are the general provisioning costs.

Senator CONROY—You often advertise free installation.

Mr Scales—That is a different issue from what we charge our wholesale customers.

Senator CONROY—There are sign-up issues. But, if you are offering free installation to your retail customers, I am just wondering what your wholesale price to yourself is.

Mr Scales—That is a different cost construct that we are talking about there. In our discussions with our wholesale customers, they are saying to themselves: 'If we want a provision for, say, 500 DSLAMs in Telstra's exchanges, what would the business case look like and what might we be able to offer a retail customer as a package?' They are different pricing constructs.

Senator CONROY—A zero sign-up is a pretty attractive offer, though.

Mr Scales—My point is that that is at the retail level with our own retail customers.

Senator CONROY—I am just wondering what price Telstra wholesale is charging Telstra retail. What is the cost, if you are giving it away free?

Mr Scales—In the same way that there are costs for wholesale customers, our infrastructure services business also has an implicit cost on our retail business. That is the cost that companies incur, sure.

Senator CONROY—We have also been told that Telstra does not offer any volume discounts for bulk transfers of customers, so it costs the same per unit to transfer one customer to another DSLAM as it costs to transfer, say, a thousand. Can I check whether that is accurate? I appreciate you may want to take that on notice, and that is fine.

Mr Scales—I will take that on notice. But let me answer it in its more general context—that is, that this is a relatively new development. This whole idea of people using their own equipment and linking into Telstra's network and then, to all intents and purposes, creating their own networks is really only a few years old. In many cases you see the extensive roll-out being debated in the press. You will have noticed that, even today, SingTel Optus are talking about the potential for substantial roll-outs. This is a moving feast.

Senator CONROY—I am refusing to read today's papers.

Mr Scales—This is a moveable feast, in terms of how one costs these things. Not even Telstra's wholesale customers are fully aware of what their needs are. Is it our intention to try to find some means by which we provide some benefit for economy of scale? Absolutely. Have we had to do this up until now? No, because in most cases it has been a relatively small number of provisionings that we have had to be involved in. So this is a bit of a moveable feast. Let me take the specific issue on notice and I will see what I can do.

Senator CONROY—It would seem absurd if you charge $90—if that were the correct figure—to undo one cable and then send the tech back somewhere else and then back out a thousand times.

Mr Scales—That is why I am saying that you need to see this in the context of history. Where a company like Telstra observed that this might be one or two on a relatively irregular basis, they

would establish a particular cost structure. If it turns out that there is significant provisioning and you enter into a discussion with a wholesale customer to go into 1,000 exchanges, then that is quite different.

Senator CONROY—You would not allow anybody else to go and change the cord over, would you? It would have to be a Telstra tech. You would not let me wander in and change it over.

Mr Scales—We certainly would not let you, Senator. The general point here is that it is our facility. While we allow technicians from other companies to go inside there, we generally want to make sure that it is done in a way that does not threaten not only our own capability but also the capability of many of our other wholesale customers.

Senator CONROY—That is perfectly understandable. So you are in a monopoly position in terms of the transfer of the cords. You are not going to let anybody else's engineer do it—understandably.

Mr Scales—That is not the point I am making here. We do give other people access to the exchanges.

Senator CONROY—I am sure they are going to want to install their own DSLAM and not have your techs install it. I understand that aspect. When we are talking about that unplug and plug, you are not going to let one of their people touch your DSLAMs, are you?

Mr Scales—No, we are not.

Senator CONROY—Another broadband related issue that has arisen is the availability of ADSL broadband on specific lines. We have heard evidence of a number of occasions on which Telstra has advised a wholesaler that it could not provide broadband over a specific line, only for your competitor to turn around and find that suddenly you have signed the same customer up on a broadband line. Could that occur?

Mr Scales—It is possible. Again, we have discussed this in other forums. It is possible because of the issue that I mentioned earlier.

Senator CONROY—It would save a lot of time on your surveys if you noticed that all this demand was coming in from this other company saying it was not available and then put DSLAM in.

Mr Scales—The reason why it is possible is that, when somebody rings up at front of house and asks whether they can get ADSL in their home or premises, the person on the line then has to go and look at our provisioning capability. They have to decide, on the basis of the information that may be available online, whether it is close enough to the exchange to say that we will be able to continually provide that service at the standard that is required. Again, generally in other forums we have talked about the fact that roughly about 3½ kilometres from the exchange is where we begin to get a query about whether we can or cannot guarantee to a customer that they can get a high-quality broadband service on that line. In some circumstances, we have found that if, for example, a person rings you up, Senator Conroy, and you look at what

is in front of you and say, 'I don't think you are going to be able to get it because you are not 3½ kilometres from the exchange; you are five,' and you might then ring up Senator Cherry, Senator Cherry would look at the same document and say, 'I just happen to know that I had somebody yesterday who rang me. While it's technically 3½ kilometres, I happen to know that it's actually not 3½ kilometres but it's flat—

Senator CONROY—And it is five in this case.

Mr Scales—and so on and it might be four, and therefore I think we can provision you.' We have had some examples of that, but it is not the generality of it. In fact, that is quite rare. These issues are generally resolved quite amicably and there is generally a reason why people might have been given that answer, but that is generally the reason.

Senator CONROY—So the constraints are engineering technical—

Mr Scales—More technical.

Senator CONROY—Engineering technical constraints about whether the line is close enough or whether or not there is a DSLAM there? Do you need to install a DSLAM to put broadband on?

Mr Scales—In the example you have given that would not be the case. That would be relatively straightforward. I doubt that somebody would be given two stories if there was already a DSLAM. It would be: 'How far are you from the exchange?' That is more likely to be the case.

Senator CONROY—Just going through that process for determining for a Telstra retail customer whether the specific line could support ADSL, what actually happens? They call up on a screen on your IT system?

Mr Scales—Yes, they ring front of house. The first thing the person would do would be to look and see whether the exchange is provisioned. Then they would try to determine where the particular location was in relation to the exchange and then they would say, 'Yes, we can provision you,' or 'We can't.'

Senator CONROY—And wholesale is on the same system? You were saying people call front of house. If we are talking about the back, do they call that up?

Mr Scales—No.

Senator CONROY—What is the connection?

Mr Scales—If you are trying to drive at the separation issue then we should come to that.

Senator CONROY—I am trying to understand if there is a separation issue at the moment by accident, because they just happen to be using two different systems, or are they on the one system?

Mr Scales—The issue there is that they would ring a different company. They would ring their own company to ask, 'Would you provide me with broadband capability?' That company would then contact us to make sure that that can be done. But the customer would ring their own IPS, their broadband provider.

Senator CONROY—I am probably not asking the question in the right way, so I might come back to it. The ACCC have identified some of these issues. I have heard Graeme Samuel speak on the issue of trying to get access to lines. I do not mean physically—'They've lost the keys; we can't get them the exchange' type of stuff—but he has referred to that as well as to this issue about access to lines.

Mr Scales—Part of the dilemma is that we know that the ACCC has raised it but we have never had any examples of this—and we have made this point with the ACCC.

Senator CONROY—I think we did got some. We had some witnesses, ISPs providers, who have statutory declarations from their customers saying things like: 'Customers who approached Telstra to ascertain whether their line supports ADSL are forced to first agree to sign up with Telstra before Telstra will inform them whether they have ADSL capacity.'

Mr Scales—I thought you were talking about the keys to the exchange.

Senator CONROY—No. I was saying I know Graeme talks about that a bit, but he has also made reference to these sorts of issues that I am talking about as well.

Mr Scales—But I thought I had addressed that issue earlier. I was saying it is possible that it could happen. The general point that I would make about this, given that this is a review of the regulatory framework, is that there are remedies for this now. The ACCC could ring us at any time about any of these issues. It can investigate any of these issues at any time. It can determine at any time, under the existing regulatory framework, whether we are acting anti-competitively. None of this is new. There are remedies, and they are available to the ACCC and to people who make complaints right at this very moment.

Senator CONROY—The ACCC think you were in breach of the law recently. They claimed you were.

Mr Scales—Which, specifically?

Senator CONROY—The broadband notice. Their press release says they believe you were in breach of the law. I know what yours said, but I am just pointing to you—

Mr Scales—That is quite relevant for this inquiry, obviously. Let us just understand what power the ACCC has here. The ACCC has the power to effectively subpoena every document inside Telstra and to subpoena every executive inside Telstra. In this particular case the ACCC took nearly 12 months trawling through a whole range of documents. We provided complete access to any document the ACCC wanted. We always believed that we had done absolutely nothing wrong. And you are absolutely right: that is what we said. The ACCC found that we had done nothing wrong.

Senator CONROY—That is not what they said. I am sure you have seen their press release. Even at the settlement point, when you all signed off, they still made the point in their press release that they believed you had breached the law.

Mr Scales—That is a matter for you and the ACCC. I am trying to explain to the committee that, if that is the case with the ACCC, why didn't they find this? Remember that literally thousands of documents were asked for and literally thousands of documents were provided. They were also, under the so-called 155 notices, able to in fact subpoena executives, and they did. They were able to question them at length, and they did. And they found no evidence of anti-competitive behaviour. The ACCC can say whatever they like. All I can say to you is: if they had that power available to them—and they did—and they could find no evidence—and they did not—why do they keep saying that?

Senator CONROY—As I said, I am just drawing it to your attention. I am sure you have seen Mr Samuel's press release of the day that the deal was announced.

Mr Scales—I think it points to the point that we are trying to make in our submissions. You raise a very important point, and it is a bit like the discussion that is going on, for example, around accounting separation. Here we have this amazing situation where the government has decided to put in place a process called accounting separation. We have not even fully implemented accounting separation, and yet people in the ACCC are saying it does not work. So the question for an organisation like Telstra when it goes before the board is: what do we say about that? Because, on the face of it, it looks as though we have a regulator that has decided that it wants to have structural separation of the company; and to ensure that it puts itself in the best position to argue the policy case for structural separation it will undermine—or at least the opportunity and moral hazard is there that it will undermine—the existing policy to ensure that its policy is implemented. So I am not surprised by any of that.

If you have a regulator which is clearly determined to become involved in the policy debate and is clearly determined to ensure that its policy outcomes are achieved, then automatically what follows from that is the potential moral hazard of the regulator establishing outcomes will ensure that that follows. So I am not surprised at the comments you are making—not by any means. They are a natural consequence of trying to achieve a policy outcome.

Senator CONROY—I thought I was posing questions rather than making comments, but I will accept your admonishment. I mentioned a number of suggestions that customers who approached Telstra to ascertain whether their line supports ADSL are forced to first agree to sign up with Telstra before Telstra will tell them whether ADSL is available.

Mr Scales—We cannot enter into a contract with somebody to provide a service and not provide it.

Senator CONROY—No, but the point is that they are phoning up and saying, 'Can you tell me whether it is possible for me to get it?' and Telstra is saying, 'Sign up with us and we'll tell you.'

Mr Scales—I have not had any examples of that happening. If people wish to provide those to us I would like to look at them. I do not know of any examples of that.

Senator CONROY—Backhaul pricing: people all over the country are going spare about the price. How does Telstra determine the price it charges for backhaul transmission across certain routes?

Mr Scales—We are actually not sure what the issue is. We have obviously been watching that and we have had nobody come to us with an issue around backhaul pricing. We have had—

Senator CONROY—Feel free, or get someone else, to read the transcript.

Mr Scales—That whole question is part of the access pricing arrangements which we enter into with the ACCC.

Senator CONROY—Yes, I understand that.

Mr Scales—We are not actually sure of the issue. We are just not sure what the issue is.

Senator CONROY—How do you determine the price you charge for backhaul transmission across certain routes?

Mr Scales—Every price is based on costs.

Senator CONROY—Is it consistent across all routes?

Mr Scales—The pricing approach would be consistent across all routes. Whether the price is consistent I could not tell you offhand.

Senator CONROY—If there was competition in an area, would the price be the same as where there was not competition?

Mr Scales—That is why you have an access regime. You have access regimes to ensure that, where there is not competition in infrastructure, the regulator gets themselves involved in what the appropriate price is.

Senator CONROY—So the answer to that would be no, prices are not consistent between areas where is or is not competition?

Mr Scales—It is about how the price is determined. The price is determined through the normal negotiations with regulators.

Senator CONROY—But what I am asking you is: where there is competition, do you have the same price where there is not competition?

Mr Scales—It is a non sequitur—

Senator CONROY—Not quite.

Mr Scales—in the sense that where you do not have competition you have access regimes and where you do have competition you do not have access regimes. That is my general point.

Senator CONROY—The answer could be yes if the agreed price with the ACCC is what you charge on a competitive route, but that is not the answer you are giving me.

Mr Scales—Let me check that out for you.

Senator CONROY—Would the prices you decide to quote for backhaul services into a region be representative of the cost that Telstra incurs when it utilises backhaul services to these regions to supply its own services?

Mr Scales—I am not sure I could answer that here today. I will need to take that one on notice.

Senator CONROY—If these costs are taken into account, given that the costs for backhaul for some reason are extraordinarily high compared to other routes, wouldn't you expect some differences in the retail prices offered across these regions?

Mr Scales—We do not know what the issue is. We have seen that it has come up in this inquiry. We do not understand it, so all I am asking is that you give us an opportunity to look at that issue and we will try to come to you with whatever information we can. We just do not understand what the issue is.

Senator CONROY—So you are saying that you get nobody at all who bothers to raise this with you?

Mr Scales—We have seen that the issue has come up in this inquiry, because we have been watching it, but it is not something that has been an issue inside the company that has seemed to us to be a major issue.

Senator CONROY—I am sure you have also seen in the evidence people saying: 'It's not even worth us raising this. There's no point us going to the ACCC. We are small ISPs. We don't have the legal resources of Telstra. It's a 12-month argument. By the time 12 months pass we would already be out of business.' The process is a minimum of 12 months. People have given up. There are ISP providers who have told us they are not even prepared to bid on HiBIS because of the price of backhaul.

Mr Scales—That is why I am saying we do not understand the issue. That is why we just need to look at it.

Senator CONROY—Okay. I want to talk about something I discovered in Dubbo called dark fibre. As you know, I am new to the area so it was a new one for me—this mysterious dark fibre. Do you have any idea how much dark fibre of yours there may be across Australia, especially in rural and regional areas?

Mr Scales—I presume you know what dark fibre is.

Senator CONROY—Yes. It is light fibre you have not turned on!

Mr Scales—No, it is not actually that; it is not that at all. Well, to some extent we have not turned it on, but it is the reason why we have not turned it on.

Senator CONROY—I understand.

Mr Scales—It is really redundancy built into the system for future need. As you would understand, if you are putting cable into an area you are trying to understand to what extent you need all of that right now or whether you should be building in for what you regard the need would be some time in the future. It is effectively a line of fibre, it is not activated and it will be used at some point in the future.

Senator CONROY—What do the people in Dubbo have to do to get the fibre turned on? It runs under their main street—and they are beside themselves.

Mr Scales—That is a slightly different issue, I think. The question, it seems to me if I am understanding your question correctly, is that they have a need for broadband and the question is how they should best get broadband. The answer to that—

Senator CONROY—It seems strange that you have a fibre cable running under the main street and you pick another vehicle.

Mr Scales—It may or may not be. But that is a different issue from the question about dark fibre. That is to make sure we have enough capacity in the future in our network. The question about whether people in Dubbo can get broadband might be a quite different issue. It might have nothing to do with fibre.

Senator CONROY—They think they could get broadband if you turned the fibre on and they could plug into it—

Mr Scales—They might, but—

Senator CONROY—which would seem to be a perfectly reasonable thought, from their perspective. It may not be what fits into your plan, but from their perspective they have recently discovered dark fibre running under their main street but half the suburbs in Dubbo cannot get broadband. They are saying, 'This is absurd.'

Mr Scales—As you know, it is impossible for me to answer that specific question in this inquiry here today. But we can—

Senator CONROY—Are you able to provide to the committee detailed information about where you have dark fibre in Australia?

Mr Scales—There would be dark fibre right across Australia, but that is not the question I am hearing you ask me. The question I am hearing you ask me is to what extent—

Senator CONROY—The first one was about Dubbo. The second one is: can you give us detailed information about where you have dark fibre that you have built in for future capacity?

Mr Scales—I know I am a bit slow, but I am trying to answer your first question, which is about Dubbo. I accept the fact that I have not fully answered your first question, about Dubbo—

Senator CONROY—But you told me you were going to go away and come back.

Mr Scales—But you asked me another question about Dubbo, which was: isn't it reasonable, if they have fibre running up and down their street, to get it? That is the question that I was answering. The answer to that question may be yes or it may be no. It depends on whether that is the best means to deliver broadband. Let me come back to you about the second question, about whether I can tell you where the dark fibre is. I am very happy to do that.

Senator CONROY—Would there be any commercial-in-confidence issue about that? I do not want to get a letter in a month's time that says, 'Sorry, we can't tell you.' Off the top of your head, or with any of your experts—

Mr Scales—It is not a commercial-in-confidence issue; it is a technical issue. We would have fibre all around the country that has what we describe as redundancy built into it. We may not be able to give you an answer with the exactness that you are asking for, but I can give you a general sense that we have it everywhere. That is just the normal way you would go around planning for a network.

Senator CONROY—What decision do you have to make to turn it on, so to speak?

Mr Scales—Demand. That is the whole point about it.

Senator CONROY—I am presuming it is more than 80 to 100. That is a DSLAM type level. What sort of demand do you need to turn the fibre on? I assume you are going to say it is more than just one point along the route.

Mr Scales—The other point about this—and I am sure that you are aware of it—is that it is not just a question about switching a signal across from one piece of fibre to another. You often have to put in place a whole bunch of other equipment to enable a signal to be sent. The fact that you have fibre is only one relatively small part of the total economics.

Senator CONROY—Laying the fibre is usually considered to be—

Mr Scales—Yes, but it is only a small part.

Senator CONROY—Laying the fibre is usually considered to be a reasonably large part of the cost.

Mr Scales—Not necessarily. If you take the most recent example of laying fibre across from Victoria to Tasmania, that is a relatively small part of the cost of getting—

Senator CONROY—There is a ship involved.

Mr Scales—It is still a relatively small part of the total cost.

Senator CONROY—You haven't got any ships laying it out in Dubbo, have you?

Mr Scales—My point was really addressing your question about the relativity of one cost to another. What I was saying to you was that, in fact, the laying of cable is not where the largest part of the cost will be. Often it will be the provisioning of other elements of the network.

Senator CONROY—It has been suggested to us that the reason that you do not activate a lot of this dark fibre is that, once it is activated, it is subject to the access obligations under part XIC. Is that a consideration?

Mr Scales—No, it is not.

Senator CONROY—Another issue that has arisen is Telstra's practices in connecting and transferring fixed line services of customers who are obtaining a retail product provided by a Telstra reseller. We have heard evidence that Telstra resellers 'hide under the desk' when customers request transfers because the process is so painful. Is there any difference in the internal process that Telstra performs to transfer or connect a line for a retail customer of a Telstra reseller compared to the process for a Telstra retail customer?

Mr Scales—In general there is no difference, but it very much depends on what that reseller wants us to do for them. Again, this is one of those cases where it is very hard to generalise. We are generally blind to whether people are wholesale customers or resale customers.

Senator CONROY—It has been put to us that some people who are transferring or retail customers of a reseller have phoned Telstra about the delay and been told: 'The delays would not have occurred if you were a Telstra customer. If you change your service to Telstra, we can arrange for this problem to disappear.' There was at least one reseller who indicated to the committee that he could obtain witness statements from his customers to this effect. Do you have a response to that?

Mr Scales—How can I—

Senator CONROY—Would that be good practice? Go to the general for a moment.

Mr Scales—The answer is no, we would not do that, nor would we countenance that, but again it is impossible at an inquiry like this to address each of those examples.

Senator CONROY—I just wanted to get on the record that it was or was not a reasonable practice to engage in. I think you have indicated it is not.

Mr Scales—But, in a way, I am trying to be honest in my response. We get all of those sorts of claims often and, when we go back and investigate, it is not exactly as somebody has described it. For example, it happens every day that somebody will ring up and, when it turns out that they are not a customer of ours, we will simply say to them, 'We cannot talk to you.' It is possible that people will interpret that as us saying that we are not interested in them. The fact is

we are not able to talk to them; they are a customer of somebody else. That is why it is very difficult to respond to comments like that.

Senator CONROY—Thanks for all of those individual issues. It was very helpful for the committee's consideration. I would like to talk now about a number of recent proposals for regulatory reform. The Page Research Centre recently recommended that Telstra be compelled to obtain customer service certification with the CSIA. You have probably seen it in today's papers.

Mr Scales—Yes.

Senator CONROY—We have also been told by DCITA when they appeared before the committee that this was the only recommendation of the Page report that they had been considering to this time. What are Telstra's views on this recommendation? Do you need to be registered with the CSIA?

Mr Scales—We do not have a particular view about that. We have entered into some discussions with this organisation. They are clearly known to us; we know that they are around. There are a number of organisations that, not surprisingly—

Senator CONROY—Are you dealing with Mr Whitford?

Mr Scales—I am not dealing with him personally, no. There are a number of companies around—

Senator CONROY—He appears to be the brother of somebody that recommended that you do it.

Mr Scales—There are a number of companies around that try to encourage Telstra to buy their services. Some of them come under different banners; some of them have different methodologies for encouraging Telstra to do one thing or another. So certainly—

Senator CONROY—It is the only body that offers certification to the international customer service standard in Australia, though.

Mr Scales—Yes, I am aware of that.

Senator CONROY—You have had some discussions but have not progressed them?

Mr Scales—Our people are still talking to them. I do not know what we will do in that regard. We have had a number of approaches from people who argue that they can help us in a range of ways. This may or may not be a sensible thing to do.

Senator CONROY—So you would like someone else to be monitoring your customer service standards?

Mr Scales—We have a number of people monitoring our—

Senator CONROY—You have us, you have—

Mr Scales—The ACA, the TIO—

Senator CONROY—That is what I mean. I have not normally found you willing to have an extra layer of the dead hand of bureaucracy, whether it be related to the National Party or not.

Mr Scales—To be fair, when you read the full Page report, in general they are arguing that, more important than the monitoring, Telstra should be looking at its general service capability. I think what this organisation says it is capable of doing is being able to help Telstra to improve its general service capability.

Senator CONROY—You think you need an outside body to help you.

Mr Scales—I did not say that. I said our people are talking to them to see what the organisation might have to offer—

Senator CONROY—If I get my brother to set up an accreditation organisation, will you enter into talks with them?

Mr Scales—If they are bona fides, I am quite happy to talk to them.

Senator CONROY—I do not have a brother, you will be happy to know, Mr Scales. The ACCC has submitted to this inquiry that the operational separation of Telstra may be an appropriate reform. The ACCC suggests that such a separation could use the ring-fencing arrangements currently in place in the gas industry as a model. Under this model, Telstra would be required to create separate legal entities for the Telstra wholesale and retail businesses that would be governed by separate boards. The ACCC further suggests that such an operational separation should: require the two businesses to deal with each other on a commercial, arms-length basis, including explicit pricing, invoicing and billing; maintain fully separate accounts and financial and non-financial reporting systems capable of capturing all transactions between the businesses; and maintain separate staff at all levels. What is Telstra's view of that approach?

Mr Scales—We have seen that suggestion, as we have seen other people define what various forms of separation might look like. This does look to me like structural separation. It has all the elements of structural separation. It has all the elements that the ACCC called structural separation less than 12 months ago. I am inclined to think that if it looks like a duck, walks like a duck and quacks like a duck then it is a duck. This to me is structural separation under another name.

Senator CONROY—Would you believe then that what BT is going through is in effect structural separation, given that what they are going through is even tougher than that in terms of ring fencing and having separate boards?

Mr Scales—We have been trying to understand what is happening at BT and we have clearly had some discussions with BT about what their model looks like. It is not clear what their model actually is and it is not clear to what extent the BT model is any one of the models that have been suggested by either the ACCC or a number of other people who are trying to define that. So I think the jury is still out on almost any of those models and what in fact they are. I think you can only truly understand what these models are not by what people are saying about them but

by how they actually operate in practice. To the extent that we understand the BT model—and we still do not understand it fully—there are elements of what Telstra does that are in many ways even more transparent than what we understand BT does and what would be required by Ofcom. So I do not think it would be clear to us yet how the BT model would line up with anybody's model.

Senator CONROY—Mr Switkowski, that well-known Essendon fan, recently made the comment that operational separation may be something that Telstra could accept depending on what it encompassed. Could you elaborate for the committee on what would be acceptable to Telstra in this respect? As opposed to what everyone else is saying, what do you guys think?

Mr Scales—We have not come to a view about that yet. It is an extremely complex issue. The question which we are always asking ourselves is: what are we trying to solve for? It is not clear to us yet what the issue is that we are trying to solve.

Senator CONROY—Haven't you met Barnaby Joyce?

Mr Scales—Once people are clear about what it is that we are trying to solve for, I think we will be in a much better position to try to help find a solution to that. We did not have a firm position at this point.

Senator CONROY—Do you think you will have a view on this within the next month or two or is that just too early in the process? The committee would be interested, if you do form a view, in getting a supplementary submission on where you are at on it. We report at the end of June.

Mr Scales—The reason I cannot answer that is, again, that it depends on a greater level of clarity about what we are trying to solve for. I think it will very much depend on that as to whether we are in a position of being able to address that issue.

Senator CONROY—I go back to your point earlier about a walking, talking and quacking duck. Structural separation is a reform that has also been suggested to the committee. I presume from your response that Telstra remains firmly opposed to the concept of structural separation. I haven't misread you there, have I?

Mr Scales—As for our position, what are we trying to resolve here? If one winds back a bit, if we have got a situation where there are high levels of competition with no clear evidence of any anticompetitive behaviour and if there are already in place remedies to be able to address the sorts of issues which you have raised with us today—and there are—why would the community want to go through a process which, however one wants to define it, will cost Telstra and the rest of the community a significant amount for the resources to do it? Why would you do it? So we come at it from that perspective. Again, I think it is a question of even this committee saying, 'What are we trying to resolve here?'

Senator CONROY—We have heard substantial evidence to the effect that separating the network and retail businesses would actually unlock shareholder value, as occurred in the energy sector, by allowing the two businesses to better understand their costs and, as a result, better manage their resources. Are you not persuaded by that?

Mr Scales—But that is not a new argument. That argument could be made of Westpac or any organisation. I presume it has come from somebody in a business school or something like that.

Senator CONROY—I was going to say it was from a variety of people.

Mr Scales—Merchant banks love that sort of stuff.

Senator CONROY—They are demanding that it all be held together at the moment. I am sure that after they have sold it they will then be demanding that it be split up.

Mr Scales—It is the stuff that strategy books are written about, so none of that is new. But that is a slightly separate question from the case that we are talking about here, which is: does the current competitive environment demand or require that there be some form of structural separation?

Senator CONROY—I accept that it is a slightly different question. The point that these people were making—and they were not necessarily arguing about whether there was enough competition to justify doing it or a need to do it—was that they actually believe that it was in the best interests of Telstra shareholders for that to happen because it would unlock value for them.

Mr Scales—My question is: how does that relate to the terms of reference of the committee?

Senator CONROY—That is just one of the arguments that some were advocating in support of structural separation.

Mr Scales—I see.

Senator CONROY—Some people are advocating the floating off of Sensis at the moment. Presumably, that is on the basis of unlocking value for shareholders.

Mr Scales—I think all of those things are appropriate for any organisation to look at, but that is not structural separation in the sense that people have defined it. People have defined structural separation as a solution to a regulatory need. In the context that the ACCC put it, it is not about releasing shareholder value; it is about addressing their perception of competition. My point is the point I made earlier: what are we trying to sell for? If your question to me is about what the best way to unlock value inside Telstra would be, then, if I were to enter into that debate with you, I would give you a range of options, of which that would be one. If you were asking me to resolve a question about the lack of competition in a particular market, I would also give you a range of options there. That is what I was trying to address in your question.

Senator CONROY—Thanks for that. You claim—and I am not sure if it is you claiming it personally, but certainly representatives of Telstra have claimed this—that structural separation would be technically impossible. Telstra has been found to have taken an overly conservative approach to technical issues of this nature in the past. Some people have put to the committee that Telstra originally claimed that interconnecting with its network would be technically impossible when competition was first introduced to Telstra. Are you being too pessimistic? Do you think there are technical problems in doing it?

Mr Scales—Before I answer that question, I do not know where that quote came from, so it is not appropriate for me to respond.

Senator CONROY—It is the mists of time on the second one, and there is the interconnecting idea.

Mr Scales—The other reason I am a bit cautious about answering your question in the way in which you have put it to me is that my guess is—and it is only a guess—that that was responding, if it were to come to something, to a particular form of structural separation with a particular set of characteristics. People would have been entitled to say, 'If you define structural separation in that way, that is technically impossible to do.' So it is not inconsistent with a view that says, yes, it is technically impossible to do.

Again, to get back to it, it very much depends on what you mean by structural separation. There are some constructs of structural separation which will be technically impossible to do. What is often not taken into account in this structural separation debate is that Telstra is a much more complex beast than it was five, 10 or 15 years ago. At that time—and I am overstating it here—it was a relatively straightforward copper network. Now we have copper; fibre; a layer on top of that, which is IT systems; and a layer on top of that, IP systems. They are completely integrated, so the question becomes: how do you make an appropriate separation of that, without virtually having Telstra as it currently is? So it is appropriate for those people who want to debate structural separation to really get their hands dirty and address those questions. To be quite frank, I have not seen anybody who has done any of the work to be able to make the appropriate judgments about the costs and benefits.

Senator CONROY—Another issue that has arisen before the committee is the influence of Telstra's ownership of the HFC on competition in telephony markets. Does Telstra currently provide telephony services over the HFC?

Mr Scales—Yes, we do.

Senator CONROY—Does it allow Foxtel to?

Mr Scales—Foxtel is not in that business. It is a different business model.

Senator CONROY—But if it wanted to? Would you object?

Mr Scales—That would be an issue for the shareholders of Foxtel.

Senator CONROY—Outline to the committee how Telstra's relationship with Foxtel works. You have 50 per cent and there are two 25 per centers?

Mr Scales—Yes.

Senator CONROY—Tell me about the construction of the board.

Mr Scales—I will not be able to get you the exact numbers, but Telstra has the chair of the board and News selects the CEO of the board. All the decisions need to be made as a consensus.

Everybody has to agree to the decisions that are made. Hence from time to time you will see robust discussion around some of the decisions that are made by Foxtel.

Senator CONROY—Finally, how much does Telstra spend in complying with the accounting separation regime? How many staff do you need to dedicate to that? I am happy for you to take that on notice.

Mr Scales—Yes, I will need to take that on notice.

CHAIR—I have one question, also on notice. In evidence this morning we heard concerns raised about the zones for local calls and for White Pages in metropolitan areas. It was suggested that these zones have not changed since 1991 and it was also suggested that Telstra is unable to effect changes because they are locked in by some form of legislation. On notice, can you provide the committee with the current maps of the local calls for the five main metropolitan areas and also for the White Pages boundaries for the metropolitan areas. Do you have any comment you wish to put on the record now about those local zones and about issues like Cranbourne and Penrith and your current approach to those issues?

Mr Scales—It might be better to put them on notice. The only editorial point I would make is that it is a highly complex issue. The moment you move a zone you create another zone. Let me take it on notice.

Senator CONROY—To flesh out my questions on notice a bit, could you double-check whether you provide telephony services over the HFC. I think it has been suggested by someone else from Telstra that you may not.

Mr Scales—It is a question about how one might define telephony services.

Senator CONROY—Sure. Perhaps you could come back to us on that.

Mr Scales—I accept the general point that not all telephony services will be provided over the HFC, but let me come back and clarify that with you.

Senator CONROY—Also, can I get some further clarity on the relationship with Foxtel. Who owns the HFC and the content? How does that interrelationship work?

Mr Scales—The HFC is an infrastructure and not in itself a provider of content. The arrangement with Foxtel has different parts of the joint venture providing different elements, and content is not provided by those who provide the service. But I will get some clarification on that.

CHAIR—Thank you for your evidence today. It is much appreciated. We will see you at estimates.

Proceedings suspended from 3.25 p.m. to 3.40 p.m.

FEIL, Mr John, Executive Director, National Competition Council

JOHNSTON, Mr Alan, Director, National Competition Council

CHAIR—Welcome. Thank you for your time today; it is much appreciated by the committee. You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I do not believe you put in a submission, but we do have copies of extracts from your reports. I invite you to make an opening statement before we move to questions.

Mr Feil—Thank you very much for the opportunity. I will let Alan kick off and then perhaps come in at the end.

Mr Johnston—I thought I might start by talking a little about the role of the National Competition Council. We do not claim to be experts in telecommunications regulations, but the national competition policy, or NCP, obligations do raise certain commitments on the part of governments that are probably relevant to the inquiry's term of reference (c). The National Competition Council's primary role is to assess governments' progress in implementing the obligations they entered into in 1995 under the national competition policy. The council makes recommendations about whether state and territory governments should receive their full allocation of competition payments. Clause 4 of one of agreements, the National Competition Principles Agreement, sets down obligations for governments relating to the structural reform of their public monopolies. It is against this backdrop that the Australian government has NCP obligations relevant to this inquiry.

In brief, the structural reform obligations are particularly important where a public monopoly is to be privatised. Privatisation without appropriate structural reform could result in a private monopoly supplanting the public monopoly, with limited net gains but considerable risks. I should stress at this point, though, that privatisation of public monopolies is not an NCP obligation but does trigger clause 4 obligations relating to, first, regulatory neutrality and, second, structural separation reviews. I will now turn to those.

On the matter of regulatory neutrality, under clause 4(2) of the competition principles agreement, governments agreed to relocate regulatory functions away from the public monopoly before introducing competition to the market served by that monopoly. Obviously, the aim there is to prevent the former monopolist from enjoying a regulatory advantage over potential competitors. In relation to that obligation, in 1997 the Australian government provided for competition in the telecommunications sector. Given that regulatory responsibility for telecommunications resides with the ACCC, the council determined that the government had met its regulatory neutrality obligations under the NCP. This was in the first tranche assessment in 1999.

Moving on to the second relevant obligation, which relates to structural separation reviews, clause 4(3) of the agreement sets out the review obligations. Before privatising a public monopoly or introducing competition, governments agreed to review the merits of separating any natural monopoly elements from potentially competitive elements. That obligation was

triggered when legislation in 1997 and 1999 provided for the part privatisation of Telstra. In its first tranche assessment, the council considered that the government had an obligation to examine the treatment of the monopoly element of Telstra—that is, the local fixed network. The council determined in that assessment that the examination should have been undertaken prior to the partial privatisation and should have involved considering the merits of structurally separating the local fixed network from the non-monopoly elements of Telstra's business. At that time, the government put to the council the view that it considered it had met its obligation and satisfied that requirement through some related reviews prior to the partial privatisation of Telstra. It also said that rather than pursue structural separation it preferred to prohibit anti-competitive conduct under part XIB of the Trade Practices Act and to institute access to telecommunications services also under the TPA. Notwithstanding that, the council did not accept those rationales and concluded that the review activity referred to by the government did not satisfy the obligation established by clause 4.

If we move forward a couple of years, in 2000 the government asked the Productivity Commission to review telecommunications regulation but instructed it not to inquire into options for the structural separation of Telstra. The commission made various recommendations to improve the efficiency of the telecommunications access regime and the government made legislative changes in response, essentially requiring Telstra to prepare separate accounts for its wholesale and retail operations, that is, accounting separation. The council's view is that the government had made an effort to meet its NCP obligations through the Productivity Commission review and the subsequent reforms. But, that said, in its latest 2004 assessment the council reiterated its view that the government should have carefully assessed structural separation of the network to fully comply with its clause 4 obligation.

There is a postscript to this story. You are probably aware that the Productivity Commission recently conducted a review of the NCP. In its draft report in October 2004 the commission proposed:

The Australian Government should widen the scheduled 2007 review of the telecommunications-specific, anti-competitive conduct regime to include consideration of the appropriateness of the structural configuration of Telstra.

Several months later in its final report the Productivity Commission tempered that recommendation to say:

The Australian Government should bring forward the scheduled review of telecommunications regulation prior to the sale of Telstra. The terms of reference should provide for an assessment of:

• whether further operational separation of Telstra's wholesale and retail arms would yield net benefits;

Operational separation is certainly more stringent than accounting separation but it is a lower order reform than structural separation. In modifying its recommendations the Productivity Commission assessed that the potential benefits of the full vertical separation of Telstra's wholesale and retail arms would not be sufficiently large to justify the efficiency and transaction costs that would be entailed. This poses an issue for the council's pending 2005 assessment. At this stage I think it is fair to say that the council generally regards Productivity Commission reviews as the gold standard in terms of independent and robust analysis.

Senator CONROY—They crawled away from that one, didn't they?

Mr Johnston—But, while the council has no reason to question the validity of the commission's recommendations, it does not consider that the analysis in the final report of the NCP scoping type inquiry is a substitute for the structural review called for under clause 4. At this juncture I might hand over to my colleague, who is prepared to venture further into some of the areas of your terms of reference.

Mr Feil—I am sure that you will realise that there is a trade-off between the scope and complexity of regulation required to moderate Telstra's market power and the structure of the business. Structural separation is likely to address both the ability and incentives for anticompetitive behaviour, whereas lower order separation is likely to reduce the ability to engage in anticompetitive behaviour principally by making such action more apparent, along with the attendant regulatory consequences. But it will have limited effects on the underlying incentive to utilise market power. It is possible that structural separation would allow for less regulation especially of those parts of the business that exhibit natural monopoly characteristics and can be effectively separated from commercial activities.

Where lower order—our term—separation options are adopted, the need for more extensive regulation is likely to rise, including regulation to maintain the separation itself. Furthermore, where stringent regulatory approaches are adopted there is a greater likelihood that further additional regulation will be necessary over time to respond to any gaps in the initial regulatory scheme. So while the cost of structural separation might outweigh the benefits in an initial period, increasingly costly regulation may make such a proposition more questionable over the long term. The clause 4 obligation in NCP is aimed at ensuring that costs and benefits of a range of structural and regulatory combinations are fully assessed in an objective, transparent and independent manner.

The council does not have a view on the merits of various forms of reform but we must reiterate that it is our view that the Australian government's clause 4 obligation still has not been met. This reflects that it is not for the National Competition Council to read down an obligation imposed by clause 4 in this sector or accept a lesser standard for the conduct of reviews of one government compared to others. It is the council's role to objectively assess the performance of all governments against the obligations they entered into and not to set or amend those obligations. What I think we are trying to say in short is that we are applying the same standards to the Australian government's reviews as we do to every other review, and on that basis the various efforts so far do not meet the requirement.

CHAIR—The report that you had commissioned from the Allen Consulting Group benchmarking micro-economic reform in Australian vis-a-vis other countries in the chapter on telecommunications, highlights again three issues—government ownership of Telstra, foreign ownership restrictions and structural separation—as the three key distinctions between Australia's telecommunications regulation and other countries. It also notes that the rollout of cable television services in Australian is generally lagging well behind that of other OECD countries and notes that the structural separation of cable television activities through incumbent telecommunications operators may help in growing the cable industry as a whole as well as providing alternative infrastructure. The report also goes on to talk about the fact that one of the other key distinctions is that mobile networks and fixed line networks in the UK and elsewhere

have been structurally separated. When you talk about structural separation, are you talking about that sort of functional aspect or the classic retail-wholesale distinction which we hear in other areas?

Mr Feil—I think the obligation that was envisaged under clause 4—and you will appreciate that clause 4 applies to a full range of government business activities, not just telecommunications—was to identify those elements of the business that are natural monopolies where realistically there is no prospect of realistic competition and to separate those from other businesses so that you cannot lever your position in a competitive business off your monopoly position in a core network type function. We would hope and envisage that any structural review would obviously have had to deal with where those boundaries are and how you determine where those boundaries are. In the absence of such a review, we are not in a position to advise or comment on where you would draw the line, and I think that is probably one of the concerns that underpins our assessment. It is not a simple obvious answer and it should have been reviewed specifically to see what the costs and benefits of various alternative splits would be. But the essence of it is to identify potentially competitive business operations and monopoly business operations that are really not going to be contestable and separate the two. That may not be a simple exercise—in fact I am sure it is not—but those costs can be incorporated into the cost-benefit models that you would use to work out where the right balance lay.

CHAIR—In your 1999 assessment you talked about the need for a review to look at the merits of structural separation of the local fixed network from the non-monopoly elements of the Telstra business, which you have just spoken about, or alternatively arrangements for ring-fencing the local fixed network and its Telstra's business units. What do you understand by the term 'ring-fencing'?

Mr Feil—I think that ring-fencing is probably one of those terms that covers a range from accounting separation through to operational separation. It does cover all manner of crimes from accounting onwards, but I think there is a reasonably clear hierarchy starting out at accounting separation, which—

CHAIR—Is not much of a fence.

Mr Feil—would be interesting but probably not all that interesting. You would think that the objective of whatever level you are looking at is to provide transparency so that, if there are cross-subsidies being operated or less than arms-length arrangements between the monopoly and the non-monopoly parts of the business, it would be intended to make them obvious to an informed and well-resourced regulator. Better still, it would be obvious to the general public and competitors. Whether you can do that through accounting separation may depend on the detail but you would expect that as you went up the hierarchy from accounting separation through to structural separation you would get greater transparency. But there are cost trade-offs and we have been asking on a number of occasions now to see a review that worked through that in a systematic, objective, transparent and independent manner. We have had various people assume the answer. We have had various people, including the Productivity Commission, hazard what they considered to be the answer, but behind that we have yet to see—

Senator CONROY—Anyone actually do it who is going to be able to make an informed judgment.

Mr Feil—We are presented with not dissimilar public interest cases across the council's whole ambit of responsibility, from a whole range of governments. We do not accept them anywhere else, either.

CHAIR—Under the competition policy agreements, obviously the Treasurer cannot fine himself for breaching national competition policy. But what does it mean, having made these—

Senator CONROY—Could I just go back one step before you go on?

CHAIR—Yes, sorry.

Senator CONROY—Who is the National Competition Council? You keep saying, 'The council thought this.' Who is the council other than you two?

Mr Feil—The NCC is currently comprised of four individuals. David Crawford is our Acting President. That is the David Crawford from Western Australia; I gather there is also one in New South Wales and they get confused regularly.

Senator CONROY—There is only one of them on the council, though.

Mr Feil—The council have only one, yes.

Senator CONROY—I thought you were suggesting there were two on there.

Mr Feil—No, that would be too confusing. Doug McTaggart is from Queensland, Rod Sims is from New South Wales and Virginia Hickey is from Adelaide. We currently have a vacant presidency, with David acting. Those are the four individuals who make up the current council. These views have been consistently presented by the council in all its existence. As well as the members of the council, all of whom are part-time appointments, we have a secretariat of, I think, 12 or 13 people at the moment, who provide the assessment advice to the council.

Senator CONROY—Just to add to Senator Cherry's question—essentially my question is the same—I know that when the state governments are recalcitrant you have fined them.

Mr Feil—Reluctantly we have recommended penalties in the latter years of the program. I think it was in the 12th and 13th year of the 10-year program.

Senator CONROY—We are about six or seven years into the Telstra debacle of them ignoring you. Who fines whom? How does it work?

Mr Feil—There are no competition payments to the Commonwealth government, so there is nothing to deduct from, so that point is moot. You may be aware from various submissions made to the Productivity Commission that a number, if not all, of the states think it would be a good idea if there was some financial arrangement.

CHAIR—The states could collect it on behalf of the people of Australia.

Senator CONROY—So the Commonwealth government can just snub its nose at its own agreement.

Mr Feil—It is an agreement among all governments. We cannot recommend a penalty, and we have not. We have made our views very clear.

Senator CONROY—You could actually recommend a penalty.

Mr Feil—The penalties are by way of a deduction from set amounts that flow from the Commonwealth to the states.

Senator CONROY—You could say, 'Look, this is worth a $10 million deduction,' if there was something for it to be deducted from. You could actually recommend a penalty, even though it would be a notional penalty.

CHAIR—Or, given that the Commonwealth benefits from the penalties to the states, you could say they will be suspended in terms of payments back to the Commonwealth until the Commonwealth actually comes through.

Senator CONROY—You are not shy about ultimately fining the states which are withholding.

Mr Feil—We are very reluctant to recommend penalties for the states.

Senator CONROY—But you have.

Mr Feil—But we have. We have also, I think, highlighted the Australian government's less than stellar performance in some areas, and that has been picked up by commentators. We know that a number of state governments are not reluctant to point out where the Commonwealth sits. I think they are third from the bottom or second from the bottom on their degree of compliance. We have made that quite clear. We think that we are meeting our obligation by providing public, objective transparency. If you read our assessment, you will find that we are reasonably forthright and do not attempt to put the Commonwealth in a better light than anyone else. We try very hard to deal with everybody with an even hand. But you are also right that there is no penalty arrangement for the Commonwealth.

Senator CONROY—How bizarre! How did those idiots sign that?

CHAIR—They were all Labor premiers at the time, weren't they?

Senator CONROY—I do not think they were all Labor premiers at the time. You have answered quite a few of my questions but I would like to go through it again just to be absolutely clear. The first sale was 1997?

Mr Feil—The first of our assessments—

Senator CONROY—The first tranche—

Mr Feil—The first assessment was 1999.

Senator CONROY—The first assessment was not complied with in 1999, and that was one-third, wasn't it?

CHAIR—Yes, it would have been. The second tranche had been approved but it was not actually sold.

Senator CONROY—Do you engage in any research into the question of structural separation yourselves? Given that they have flouted it, do you say, 'Well, you are going to flout it and continue to treat us with contempt, so we will do it ourselves'?

Mr Feil—One of the operating principles revolving around the council is that we do not do reviews because it is our job to judge them. In the early period of NCP the council did engage in some relatively minor reviews. Then there was a review of what was going on by the Productivity Commission and one of the recommendations was that the council should not do that. I think that is probably quite sensible. You really cannot be the judge in your own court. So of course if we did a review it would meet the gold standard without any question, particularly when we were judging it.

Senator CONROY—You did not have to judge it. You could just help the debate by commissioning one yourselves.

Mr Feil—It is not something that we have contemplated doing. The reviews that we have commissioned or the reports that you have have been very much ex post to look at what had happened. The obligation is not to have a third party or to have us undertake a review; the obligation is for the government with relevant responsibility to undertake a review.

Senator CONROY—You did actually commission Tasman Asia Pacific economic consultants in 1999 before its second tranche assessment and Tasman's findings suggested that the advantages of structural separation would exceed its costs. It also predicted that the accounting separation regime would be inadequate and operational separation would also be a second-best solution. It does seem to be on the mark so far.

Mr Feil—I think it is one thing to provide a framework—and we try and do that—but to actually conduct the review itself and then assess whether or not the review then being done meets the requirement—

Senator CONROY—I am not suggesting that you actually then review your own work. I appreciate that that is a little problematic. But you did actually do it and I am just wondering whether you are going to do it again. Graeme Samuel was the president at the time.

Mr Feil—There are no current plans to do a review of structural separation of Telstra or to commission one at this point.

Senator CONROY—So you have given up?

Mr Feil—We will be doing our 2005 assessment and you may find words remarkably similar to the 2004 assessment. There is also some prospect, you never know, of the matter being taken further but that is a matter for the government. They know our views. We are working through the 2005 assessment now.

Senator CONROY—You did reiterate in the second tranche assessment that the government should further consider the structure of Telstra, including the option of structural separation of the fixed network, and the government ignored you again.

Mr Feil—There has not been a review.

Senator CONROY—Did the NCC also at the time request that the government examine the costs and benefits of alternatives to the current regime, including structural separation, as part of its 2000 review of part XIB of the TPA?

Mr Feil—I believe so.

Senator CONROY—And the government explicitly directed the Productivity Commission not to look into the terms of reference of this report.

Mr Feil—Yes.

Senator CONROY—Did the NCC make a submission to the aborted 2002 parliamentary committee established to inquire into the structural separation of Telstra? Did you get a chance before Alston closed it off?

Mr Feil—Yes, we did make a submission.

Senator CONROY—Have you got a copy? Is a copy available?

Mr Feil—I presume it is a public document. Yes.

Senator CONROY—I will admit this—

Mr Feil—It is dated 20 January 2003.

Senator CONROY—That is exactly the same one. It says, 'This submission reiterated the NCC's view that the cost of structural separation outweighed the benefits and it should be invested by the government.' I am reading from your own submission.

Mr Feil—I just wanted to check, because our normal approach is that we do not have a view on what the outcome of the review should be. There is evidence that there are trade-offs to be made, and we would just like to see the review.

Senator CONROY—Sure. I just thought we could have a few general questions—we were joking about your experience with ring-fencing! The submission says, 'Consistent with the Hilmer report, the NCC's preference, all things being equal, is for vertically integrated monopolies to be structurally separated rather than ring-fenced.' Is that correct?

Mr Feil—If the costs of doing that are greater than the benefits compared to any alternative, yes. You would hope that that would lead, over time, to less regulation.

Senator CONROY—So what do you think are the shortcomings? You have talked about a second best and different tiers. What are the shortcomings of operational separation style regimes?

Mr Feil—One I alluded to in my opening comments is that it does not really address the incentives issue; you are still part of the same business—why wouldn't you help the left hand and the right hand? It will, depending on the detail, provide for greater transparency in dealings, as between parts of the business, depending on where you make the separation and how it is made. So it does not deal with the incentives. It involves regulation to enforce, so there is a layer of regulation necessary to make sure that the ring-fencing, or the operational separation, is put in place. In a dynamic industry you would not expect the bright line to necessarily remain stable over time, so you need a mechanism to deal with the regulation needing to be changed over time.

Senator CONROY—Would it surprise you to know that prior to your arrival here Mr Scales on behalf of Telstra suggested that, given all the rules and the accounting separation, they were proving to be remarkably successful; Telstra was not involved in any anti-competitive behaviour and had never been proved to be; and now was the ideal time to wind back regulation.

Mr Feil—That would not surprise me.

Senator CONROY—What is your view of those comments?

Mr Feil—That is not something I have looked at, so I do not have a view.

Senator CONROY—How effective are ring-fencing regimes that do not require the formation of separate legal entities for the separated units?

Mr Feil—To the extent that I have experience that is relevant, you would hope that the more transparency that could be put into the regime the better, and the more it looks like a regime that operates under normal corporate principles the easier it is going to be to monitor what is going on. So you would hope that something that was not unique and did not just deal with accounting separation would go further in meeting the need for transparency and the ability to monitor from outside. But it is not something I have a great deal of expertise in. Again, that is something that a properly constructed review could consider.

Senator CONROY—Can you offer the committee any guidance as to the sorts of governance issues that would be posed by such an approach? You alluded to the incentive issue and why wouldn't the right hand help the left hand. I have thought about this and I have spent some time looking at corporate governance over the last six or seven years. What about going so far as to have independent directors to try to solve those issues?

Mr Feil—I would love to help you but I really do not know. I have thought about it from time to time, probably in the same vein as you have, but it is not something I have particular expertise in, nor has the council researched it. I suspect there are, clearly, much greater governance issues

around anything short of separate companies where each set of directors has an obligation to their shareholders and to the company.

Senator CONROY—Even if they are separate legal entities and they still have that responsibility to the one set of shareholders?

Mr Feil—Then the incentives question I raised earlier must arise. Presumably, there will have to be some special provisions to allow them to separate or somehow work out when they—

Senator CONROY—A Chinese Wall.

Mr Feil—You would certainly think it was going to require something in addition to the normal Corporations Law that enables them to act in the interests of the overall group rather than a specific company—

Senator CONROY—Could you give us any examples of any of the state governments that have tried the same sort of line with any of their monopolies that they have been converting and where you have had to say, 'Nice try, but no'? Is there anything comparable, like gas, electricity or water? Has there been as big a try-on by any of the state governments?

Mr Feil—There have been plenty. But I think, generally, all the governments we have dealt with have been pretty clean on getting regulatory functions away from business functions. That was done pretty early and it was reasonably well done. Beyond that, most of them either have kept it as a state owned enterprise or a state corporation type model or have sold the business and it is no longer an issue. I cannot think of any. I suppose Western Power—

Senator CONROY—WA electricity?

Mr Feil—Yes. That is one where, depending on what emerges over there in the next—

Senator CONROY—You have been pretty ferocious. I will not say that you have been holding the Western Australian government to ransom or hostage, but you have been pretty ferocious.

Mr Feil—To date, they are probably the exception to proper separation. They have only in the last year or so properly separated the regulatory functions. They are still deciding what they are going to do in terms of structural separation. In that case, there was a review that recommended a specific structural separation. We are asking the Western Australian government to meet that.

Senator CONROY—And if they do not, will you fine them?

Mr Feil—We have, and there is a suspended penalty now.

Senator CONROY—How much did you fine them previously?

Mr Feil—It was 20 per cent of their competition payment.

Senator CONROY—So you have withheld that so far, and with a suspended fine to come.

Mr Feil—We have suspended that so far. Depending on what happens, they can get that back. They have gone quite a long way. They now have market mechanisms operating. The remaining bit is the structural separation of Western Power.

Senator CONROY—My understanding from what you have explained so far is that there is an obligation to hold a review, but there is not necessarily an obligation to adopt the findings of the review. How does that work?

Mr Feil—I think there is an obligation to—

Senator CONROY—Are you the judge and jury at that point?

Mr Feil—No. There is an obligation to undertake the findings of the review in that case. There was a public interest review that said there was not a public interest in continuing the regulatory scheme they had. That brings forth an obligation to reform the regulation. There is always some room for debate on the specifics, but we have asked the WA government to implement what the review said. They have done good parts of that, but they have not yet managed to do the structural separation of that business.

Senator CONROY—But they get a pretty hefty fine, 20 per cent, if they do not.

Mr Feil—We are anxious that they do. It is an ongoing current discussion. But the most recent public statements from the government are that they intend to try and implement that split, and we hope that they succeed.

[4.15 p.m.]

FLETCHER, Mr Paul, Director, Corporate and Regulatory Affairs, Optus

CHAIR—Welcome. The committee has received your submission as submission No. 12. Do you wish to make any amendments or additions to that submission?

Mr Fletcher—No.

CHAIR—You are reminded that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. I now invite you to make an opening statement before we move to questions.

Mr Fletcher—Thank you. Optus is pleased to appear before the committee. With it looking increasingly likely that Telstra will be privatised, the public policy debate has moved on to the policy measures necessary to bolster and stimulate competition once the incumbent telco is 100 per cent privately owned. Optus has argued for initiatives in three areas. First, we have called for what we have termed 'bridge-to-broadband'. We would like to see a specific policy measure designed to encourage Telstra's competitors to roll out the most extensive possible broadband networks. Our argument is based upon the model that was used by the government in the early 1990s to encourage the competitive roll-out of GSM mobile networks. At that time, the government had a policy with two elements. The first was to sign up Optus and Vodafone to network development deeds requiring us to commit to certain roll-out targets. The second was a specific decision taken to set the resale rates on Telstra's AMPS mobile network at levels that allowed reasonable resale margins to the new entrants so that we could build up a customer base and, in turn, to assist in funding our own roll-out. Optus believe that that model is a successful one and that it would be timely to revisit it in the context of broadband.

We have been arguing that the government should effectively equip itself with an additional policy tool by legislating to give itself the power to set concessional resale rates. We have proposed a rate of 10c per call for local call resale and $25 per month and, in exchange for granting these concessional resale rates to operators that commit to build out broadband networks, the government would enter into network development deeds with those operators, under which those operators would give commitments to reach certain build-out targets.

The second set of measures that we have argued for are measures to achieve competitive neutrality in rural and regional telecommunications. Those come under two headings. Firstly, there has been a substantial amount of taxpayers' money allocated to boosting rural and regional communications networks over the last few years, but the lion's share of that has gone to Telstra. We believe more attention needs to be given to competitive neutrality issues in the allocation of that funding and any funding that may be associated with T3. We would certainly acknowledge that the government has paid much more attention to competitive neutrality issues in the last two or three years. Secondly, we have consistently highlighted the impact of the present funding arrangements for the universal service obligation, which we argue tends to suppress competition in rural and regional Australia.

The third overall set of measures that we have called for are measures to optimise and improve the present telco's regulatory regime, principally contained in parts XIB and XIC of the Trade Practices Act. We have argued that there should be a general non-discrimination rule that applies to Telstra. We have also argued that there should be a 180-day restriction on Telstra wind-back activities, as applies in Canada, and we have made comments about the operational separation proposals under that heading. Our view on operational separation is that it is a policy direction which is worth exploring, but there are some issues that need to be thought through pretty carefully.

CHAIR—Thank you. Quite a few issues bounce out. I am just trying to think through the legals of how the bridge-to-broadband proposal would work. You are suggesting that it be for a short term—possibly for a couple of years and subject to specific commitments. Would you be reasonably confident that, at that wholesale price, Telstra would not be providing those services at a loss to a competitor?

Mr Fletcher—To answer the first question—what would the legal framework be—and then come to the second question, in terms of the legal framework, we think that the government would probably need to legislate to give either the minister or the ACCC the power to grant that concessional wholesale funding. As to the question of whether it would cause Telstra to incur a loss, we strongly doubt that that would be the case. That is for two reasons: firstly, because Telstra's network has been built over many decades and is fully depreciated, so the incremental cost to Telstra of providing resale services is low; and, secondly, and even more importantly, we would anticipate that this measure would greatly stimulate the take-up of and activity in broadband—that is, if you encourage Optus and other players to build more extensive broadband networks than we might otherwise have contemplated, you will get higher levels of broadband penetration and higher levels of activity.

What you consistently see in the telco industry is that when you have players other than Telstra, who are also out there marketing a service vigorously, particularly in a relatively new category like broadband, you increase the level of activity at the level of take-up. So we would expect that the increase in market penetration would produce benefits to all players, including Telstra, and that would need to be factored into the equation when you ask what the net financial impact was on Telstra.

CHAIR—You indicate that, because the government has consistently rejected structural separation as an option, you see little point in making a case for such reform. You indicate that you would like to see some further changes to transparency in terms of Telstra pricing, pointing to some of the Ofcom research. Then you go on to suggest that an antidiscrimination provision would be reasonable, as found in EU directives, which is mentioned on page 19 of your submission. Isn't there a contradiction there? I would have thought the ACCC, in trying to prove an antidiscrimination provision, would need the sort of information that it currently does not have, which can only come from some version of operational structural separation.

Mr Fletcher—What we are arguing is that there is a significant category of conduct by Telstra today which does not meet the existing threshold in the legislation of a substantial lessening of competition, so the ACCC tend to take the view that it is not worth investigating because they do not believe they would be able to make a case in court. Equally, we and others take the view that it is not worth us bringing a private action, because, again, we would face the same thresholds.

What we believe an antidiscrimination rule would do is to set a standard requirement that Telstra cannot deliver preferential services to itself as compared with its competitors. Things that we see, for example, are Telstra offering more rapid connection times to customers who purchase services from it directly rather than purchasing services via us as a reseller or, in some instances, Telstra simply refusing to make a service available to resellers even though it is available to its own retail customers.

An example of that is a service that Telstra has right now called Business Grade DSL. We have been seeking to get that service to be able to resell to our own customers for many months—probably 12 months. Telstra's initial position was, no, you cannot have it, and the reason given was that the retail business did not want us to have it. Telstra's more recent position is that they are studying the matter, and they are looking to see whether they can provide a wholesale service, but one might expect that it is going to be studied quite thoroughly.

So there is a range of conduct that is visible to us and to other players in the market that we can provide evidence of today. But because of, I guess, the technical legal drafting of the Trade Practices Act today, it is not sufficient to be able to issue a competition notice or otherwise take action, whereas if you were to have a generalised non-discrimination rule so that that of itself was a requirement that applied to Telstra without needing separately to demonstrate anticompetitive effect then we think that you would be able to get to quite a lot of conduct that occurs today on Telstra's part which tends to reduce the capacity of competitors to have an impact on the market.

CHAIR—The other change you were suggesting was the 180-day prohibition on win-back subscribers, based on the Canadian experience. You mentioned Bell Canada, but are there provisions like that in any other jurisdiction?

Mr Fletcher—That is the main one we have identified that provides a useful example. The logic behind it is, essentially, that the first few days in which a competitor wins a customer from Telstra is the point at which the customer is most vulnerable to being churned back and the point in the competitive process which is the most expensive because you have incurred the acquisition costs but you have not started to generate any revenue. For that reason Telstra, like the incumbent in Canada, has pursued a strategy, which is clearly rational for it to do, of focusing on seeking to win back customers who have moved across to competitors. That is why we think it is a constructive area to focus on.

CHAIR—You say that you do not believe there is a need to expand the USO regime. The Australian Council of Social Service has suggested that the US regime should be extended to put a requirement on all carriers to put in place measures for low-income earners. You would be aware that Telstra has a fairly large program on that. Does Optus have any such program?

Mr Fletcher—Let me answer that in two ways. Firstly, the program that Telstra has is, as I understand it, largely associated with their compliance with the price caps system. Telstra made some commitments just before the last round of price caps was introduced. Because we are not subject to the legal requirement of the price controls, we are not in the same position of negotiating with government some offsets in terms of programs for low-income customers. Having said that, we are clearly subject to the economic incidence of the price cap system. The second point is that we believe the impact that we can have as a competitor is to deliver

continued pressure for improved pricing, improved service and greater innovation to benefit customers in all income segments. We believe that is where we make our most effective contribution.

CHAIR—Does Optus have an economic hardship policy in terms of customer relations?

Mr Fletcher—Certainly if we have customers who are experiencing difficulties in payment then we will engage in discussions with them to see whether we can come up with appropriate arrangements.

CHAIR—There is no equivalent to the $5 million fund Telstra set up or any arrangements like that?

Mr Fletcher—No.

CHAIR—Do you have any objections to that being placed in a consumer code or even as a licence condition across the board?

Mr Fletcher—Our view is that the policy intention and thrust behind the regulation of telecommunications in Australia is to unleash the power of competition so as to ensure that the incumbent is subject to price discipline and pressure to deliver new services so that you get the kind of innovation, price competition and delivery of new services that you have seen, for example, in the mobile sector, which is far and away the most competitive part of the market. We think that the right policy settings are to encourage competition in the most effective way possible and that is what is going to deliver policy benefits to telecom consumers. If separate equity measures are necessary then we think that those are appropriately dealt with in a transparent on-budget fashion.

So you have got a set of measures that apply in the telco sector that to some extent reflect the historical position that the telecommunications services were provided by a government department, effectively, and you therefore had a mix of policy objectives you were trying to achieve. As you move from that to a structure where you have a range of privately owned competitors then we think it becomes more important to have a clear distinction between competition measures on the one hand and equity type measures on the other.

CHAIR—Does Optus provide any concessions for pensioners or health care card holders?

Mr Fletcher—No.

Senator CONROY—You indicated at the end of your opening submission that you had concerns about operational separation. Would you like to outline those concerns?

Mr Fletcher—Rather than saying we have concerns, I would say that we have certainly expressed the view that the government is to be congratulated on its commitment of policy energy in exploring operational separation, and we are very interested in playing our part in having an input into that process. There are quite a number of issues of detail that need to be worked through as you look at introducing potentially an operational separation model. We think that, as with all public policy, you need to have a test of weighing up the costs and the benefits.

If we take the example of accounting separation, which is part of the regulatory arrangements that exist today, I know most players, including the ACCC, will now say that the costs of the accounting separation measures are not justified by the benefits that it delivers. We are making the point that operational separation needs to be carefully designed and we need to collectively have a clear view as to the benefits that it can deliver. It seems to us that if it is well structured then it certainly could deliver benefits in terms of greater transparency as to the basis on which Telstra delivers services to its retail business and retail competitors.

As I mentioned in my earlier comments about Business Grade DSL, we repeatedly have the experience at Optus—and I am sure our smaller competitors have a similar experience—that Telstra refuses to make available a service to Telstra's retail competitors because Telstra's own retail business does not want us to have that service, even in circumstances where there is profitable business for Telstra Wholesale. In our view that is a problem that could be potentially be solved or at least be addressed in part by operational separation measures. If you had the wholesale, the network or the access business, call it what you will, required to specify what its products are, to provide those products to the Telstra retail business at an openly known price and to provide the same products to Telstra's retail competitors at the same price or a price that varies only by reference to legitimate commercial criteria such as the size of the order that you are placing with Telstra, for example, we think that could go some way to addressing the problem that today Telstra is able to stymie some competition in the retail market by simply refusing to supply services or supplying services to its retail competitors which are not of the same quality or with the same speed as it supplies to itself.

What would also follow from that is that, if you then required the network or the access business to prepare its accounts on the basis of the services that it sold to the retail business—with its revenue determined as the number of services it sold times the price—and if you then required the retail business to prepare its accounts on the basis that it was buying in inputs, then what would emerge from that would be a set of accounts for the two businesses which would indicate whether either of them was making above normal returns. This would give some of the clarity which is presently lacking in the output from the existing accounting separation reports.

Senator CONROY—It is just one of the strange coincidences of these hearings so far that there are only three companies or individuals who have appeared before us who have expressed even the remotest concern about the structural separation debate or even the operational separation debate. They are AAPT, you and Telstra—three vertically owned telcos. Do you think it is a coincidence you are the only three companies and individuals who have put in a submission to appear before us who have got any doubts at all about this argument? Everyone else has been gung-ho for it.

Mr Fletcher—The point we would make about the perspective we bring is that we have been competing with Telstra, and purchasing services from Telstra, since 1992.

Senator CONROY—Or trying to.

Mr Fletcher—We compete very successfully with Telstra.

Senator CONROY—No, I meant trying to purchase the services.

Mr Fletcher—We have been trying to purchase services quickly and generally managing to purchase the services ultimately.

Senator CONROY—If they were separated and they were a wholesaler that was not in any way beholden to the retail arm, I am sure there would not be a one-year wait.

Mr Fletcher—We certainly believe that if the people charged with selling services in the wholesale division did not have one eye over their shoulder looking at what retail was going to say—

Senator CONROY—They would leap at an opportunity to do a deal with you.

Mr Fletcher—they would leap at an opportunity—as you would expect in a normal commercial arrangement. To go back to your question: because of our relatively long history in dealing with Telstra and in going through a range of regulatory cycles in the Australian industry, we probably look to proposals that are made with the benefit of some experience about what has happened in the past and where proposals have been made that perhaps have not lived up to their initial promise.

Senator CONROY—To be fair, there were some sceptics on accounting separation who said it would not work at all.

Mr Fletcher—Yes. That is true.

Senator CONROY—I can read you one here. The NCC, the previous witness, did a study with Tasman Asia Pacific, who absolutely said accounting separation will fail to deliver any of its alleged benefits. They also went on to say that operational separation would have the same result. We may get to test that one out.

Mr Fletcher—The appetite that the government has expressed to explore these issues is one that we are pleased to see. We certainly want to participate and are participating in offering up our expertise and our perspectives on the issues. As I said, there are some quite detailed issues. For example, the UK model that has been proposed seems to focus largely on the delivery of unconditioned local loop services rather than resale services. The logic behind that is that it is probably easier to focus on the definition of and then, in turn, the cost of the service, which is access to the Telstra network from the exchange to the home. Once you start looking at resale services, such as local call resale, where, in delivering that service, Telstra is using a more extensive range of network elements—including exchanges and potentially including its transmission services and so on—then the costing issues and all of the other issues become much more complex.

One can see why it might be argued that operational separation should focus on unconditioned local loop services only. But on the other hand I think there are probably very good reasons that you would argue that if it is to be effective it needs to also focus on resale services, because the reality is that resale is a large part of the telecommunications market today and will probably remain a significant part for a number of years to come. Even if the development of the broadband market achieves all of the most optimistic expectations that people in government have and that people within Optus and Telstra's other competitors have, it is going to take a

number of years before customers are all transitioned from resale to broadband networks over unconditioned local loop. It is likely that resale will remain a significant part of the picture for a number of years. Therefore an operational separation model that did not include resale might well be open to question. So there are some real issues of detail that need to be debated here.

CHAIR—Thank you very much for your evidence this afternoon. The committee has resolved to publish all documents that have been tabled today.

Committee adjourned at 4.41 p.m.