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SENATE

SELECT COMMITTEE ON NATIONAL BROADBAND NETWORK

Reference: Implications of the proposed National Broadband Network

TUESDAY, 11 NOVEMBER 2008

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**SENATE SELECT COMMITTEE ON
THE NATIONAL BROADBAND NETWORK**

Tuesday, 11 November 2008

Members: Senator Fisher (*Chair*), Senator Birmingham (*Deputy Chair*), Senators Lundy, Ian Macdonald, Nash and Sterle

Senators in attendance: Senators Birmingham, Fisher, Ludlam, Lundy, Macdonald, Minchin, Nash and Sterle

Participating members: Senators Abetz, Adams, Arbib, Barnett, Bernardi, Bilyk, Mark Bishop, Boswell, Boyce, Brandis, Carol Brown, Bushby, Cameron, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Eggleston, Ellison, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Forshaw, Furner, Hefferman, Humphries, Hurley, Hutchins, Johnston, Joyce, Kroger, Ludlam, McEwen, McGauran, McLucas, Marshall, Mason, Minchin, Moore, O'Brien, Parry, Payne, Polley, Pratt, Ronaldson, Ryan, Scullion, Stephens, Troeth, Trood, Williams, Wortley and Xenophon

Terms of reference for the inquiry:

1. To inquire into and report on:
 - a. the Government's proposal to partner with the private sector to upgrade parts of the existing network to fibre to provide minimum broadband speeds of 12 megabits per second to 98 per cent of Australians on an open access basis; and
 - b. the implications of the proposed National Broadband Network (NBN) for consumers in terms of:
 - i. service availability, choice and costs,
 - ii. competition in telecommunications and broadband services, and
 - iii. likely consequences for national productivity, investment, economic growth, cost of living and social capital.
2. The committee's investigation should include, but not be limited to:
 - a. the availability, price, level of innovation and service characteristics of broadband products presently available, the extent to which those services are delivered by established and emerging providers, the likely future improvements in broadband services (including the prospects of private investment in fibre, wireless or other access networks) and the need for this government intervention in the market;
 - b. the effects on the availability, price, choice, level of innovation and service characteristics of broadband products if the NBN proceeds;
 - c. the extent of demand for currently available broadband services, what factors influence consumer choice for broadband products and the effect on demand if the Government's fibre-to-the-node (FTTN) proposal proceeds;
 - d. what technical, economic, commercial, regulatory and social barriers may impede the attainment of the Government's stated goal for broadband availability and performance;
 - e. the appropriate public policy goals for communications in Australia and the nature of regulatory settings that are needed, if FTTN or fibre-to-the-premise (FTTP), to continue to develop competitive market conditions, improved services, lower prices and innovation given the likely natural monopoly characteristics and longevity of the proposed network architecture;
 - f. the possible implications for competition, consumer choice, prices, the need for public funding, private investment, national productivity, if the Government does not create appropriate regulatory settings for the NBN;
 - g. the role of government and its relationship with the private sector and existing private investment in the telecommunications sector;
 - h. the effect of the NBN proposal on existing property or contractual rights of competitors, suppliers and other industry participants and the exposure to claims for compensation;
 - i. the effect of the proposed NBN on the delivery of Universal Service Obligations services;
 - j. whether, and if so to what extent, the former Government's OPEL initiative would have assisted making higher speed and more affordable broadband services to areas under-served by the private sector; and
 - k. the cost estimates on which the Government has based its policy settings for a NBN, how those cost estimates were derived, and whether they are robust and comprehensive.

3. In carrying out this inquiry, the committee will:
 - a. expressly seek the input of the telecommunications industry, industry analysts, consumer advocates, broadband users and service providers;
 - b. request formal submissions that directly respond to the terms of reference from the Australian Competition and Consumer Commission, the Productivity Commission, Infrastructure Australia, the Department of the Treasury, the Department of Finance and Deregulation, and the Department of Infrastructure, Transport, Regional Development and Local Government;
 - c. invite contributions from organisations and individuals with expertise in:
 - i. public policy formulation and evaluation,
 - ii. technical considerations including network architecture, interconnection and emerging technology,
 - iii. regulatory framework, open access, competition and pricing practice,
 - iv. private sector telecommunications retail and wholesale business including business case analysis and price and demand sensitivities,
 - v. contemporary broadband investment, law and finance,
 - vi. network operation, technical options and functionality of the 'last mile' link to premises, and
 - vii. relevant and comparative international experiences and insights applicable to the Australian context;
 - d. advertise for submissions from members of the public and to the fullest extent possible, conduct hearings and receive evidence in a manner that is open and transparent to the public; and
 - e. recognise the Government's NBN proposal represents a significant public sector intervention into an increasingly important area of private sector activity and that the market is seeking openness, certainty and transparency in the public policy deliberations.

WITNESSES

GALLAGHER, Mr William David, General Counsel, Public Policy & Communications, Telstra Corporation Limited1

QUILTY, Mr David, Group Managing Director, Public Policy, Telstra Corporation Limited.....1

WARREN, Dr Tony, Executive Director, Regulatory Affairs, Telstra Corporation Limited.....1

Committee met at 7.03 pm**GALLAGHER, Mr William David, General Counsel, Public Policy & Communications, Telstra Corporation Limited****QUILTY, Mr David, Group Managing Director, Public Policy, Telstra Corporation Limited****WARREN, Dr Tony, Executive Director, Regulatory Affairs, Telstra Corporation Limited**

CHAIR (Senator Fisher)—I call this meeting to order and declare open this public hearing of the Senate Select Committee on the National Broadband Network. I would like to extend a welcome to all present, and in particular to our witnesses from Telstra, Mr David Quilty, Dr Tony Warren and Mr Bill Gallagher who will be providing evidence on behalf of Telstra here today. This is essentially the fifth occasion of this Senate select committee conducting a hearing into the national broadband network.

As experienced Telstra operatives you may or may not be familiar with some of the rudimentary procedures around giving evidence to a Senate select committee, so I will just run through a couple of nuts and bolts very quickly. Firstly, the evidence that you provide to this committee is public. If at any stage you wish to provide evidence in camera you may request of the committee that you do so and the committee will consider that request and act accordingly. The evidence that you give is protected by parliamentary privilege; it is unlawful for another party to attempt to influence or otherwise act inappropriately in respect of the evidence that you provide to the committee and, indeed, it can be in contempt of the Senate to do so, as it can be for a witness to provide false or misleading evidence to the committee.

If, in the course of answering questions from me or any of my colleagues as part of this inquiry, you consider it necessary to object to answering some or all of a question, you are able to state to the committee that you wish to object to answering that question and outline to the committee your grounds for doing so. The committee will then consider your request and act accordingly. There is provision in that respect to have evidence given in camera if that is appropriate.

The committee has a copy of the submission that Telstra has provided to the department, given that you have not provided a written submission to this actual inquiry. Normally I would ask a witness whether they wish to make a brief opening statement, but in Telstra's case the committee is very much pleased by the fact that Telstra has chosen to attend this critical hearing into the national broadband network. We thank you for making yourselves available, and in anticipation of what you might wish to put to the committee. On this occasion I would prefer to say to Telstra that we have an allocated time frame of an hour and a half. We are essentially in your hands, although I certainly expect that my colleagues and I will want to ask you some questions.

Mr Quilty—Thank you. We do have an opening statement, which we would like to read out if possible.

CHAIR—Yes.

Mr Quilty—Thank you for the opportunity to appear before the committee. I will start by saying that Telstra supports the government's vision of providing high speed broadband to all Australians. Australia needs and deserves a world-class national broadband network. It is vital to the nation's future. High speed broadband is the great economic and social enabler. The NBN will drive productivity, create jobs, encourage innovation and scientific discovery and enhance Australia's international competitiveness. It will help facilitate the delivery of world class health and education services, particularly in regional Australia, and it will enable Australians to better look after their natural environment.

Telstra's conservative estimates indicate that every month the NBN is delayed costs Australia some \$200 million in lost productivity. Building the NBN will require a massive upgrade of Telstra's existing network. Telstra has guaranteed that its upgraded network will be open access and available to its competitors on an equivalent basis. Unlike others who have demanded a legislated monopoly if they were to build the NBN, Telstra would welcome infrastructure competition. Telstra's commitment to open access and infrastructure competition renders any calls for further separation both unnecessary and irrelevant.

The shareholders of both British Telecom and Telecom New Zealand have suffered very significant share price drops in the wake of separation. This year the BT share price has fallen some 58 per cent and Telecom New Zealand has dropped some 46 per cent. Both have severely underperformed their respective markets. In the case of both BT and TCNZ the making of wrong decisions on separation and the lack of an integrated business model has increased costs, stifled investment in next generation infrastructure, caused an over-emphasis on low margin businesses, brought about major reductions in share price and destroyed shareholder value.

Telstra has a detailed rebuttal of separation and a share price comparison of Telstra BT and TCNZ, which we would like to provide the committee. Telstra is not alone in its stance that separation is unnecessary. Kip Meek, who is the former Ofcom commissioner who was centrally involved in the separation of BT, has inspected Telstra's systems and commented that they are the same systems that the UK regulator had in mind when it mandated the separation of BT. He said:

The UK form of separation was designed to address severe problems of non-price discrimination which, on the basis of the evidence I have seen, do not exist to the same extent in Australia... I would not recommend that the UK form of separation be used as a starting point in the Australian context.

Mr Meek also observed that, unlike Ofcom, the ACCC has extensive and flexible powers to address any discriminatory conduct. The lack of any such powers in the UK was a key reason why Ofcom pursued a more interventionist approach of operational separation. Professor Martin Cave of the Warwick Business School and advisor to the European Commission on Broadband Economics stated:

Separation imposes a rigid, inflexible structure on a business which is not easily reversed. The UK model of functional separation, although only implemented 30 months ago, already seems at risk of being overtaken by technological change.

Additionally, respected industry analyst Ovum has recently warned that naive approaches to the issue of Telstra separation could do serious damage to the industry in Australia and its separation is simply unnecessary.

Telstra is a vertically integrated company. We are three years into a five-year, \$20 billion end-to-end transformation of our company. It is predicated on maintaining the company's vertically integrated structure. Without clarity that we will not be further separated, Telstra is not in a position to participate in the NBN. There is no business case with further separation and operationally Telstra simply cannot build or maintain a world-class NBN with further separation.

For three years Telstra has been looking to build a fibre-to-the-node network in Australia. We put three separate proposals to the previous government and/or the ACCC, but unfortunately could not proceed because of an inability to achieve the regulatory certainty required to make such a major investment of our shareholder's capital.

The NBN needs many billion dollars of new investment. It needs a labour force of several thousand and access to the world's leading broadband technology suppliers. Telstra believes the building of the NBN should proceed as expeditiously as possible and it is time to make the necessary decisions to enable this investment to occur. Long and delayed processes are causing significant uncertainty and are holding back this industry and the nation.

With clarity on separation and if the economics makes sense for our shareholders, Telstra stands ready to build the NBN. This is an upgrade of Telstra's network, which we know intimately. Telstra has the technology, the know-how, the skills, the financial backing, the resources, the world's leading suppliers and the track record of getting things done. We recently rolled out the Next G network, Australia's largest and fastest national mobile wireless broadband network, which is being used to provide the next generation of mobile broadband services to metropolitan and regional Australia.

If Telstra builds the NBN we will use the world's best technologies. The network will be robust and reliable, and it will be importantly upgradeable to take advantage of further advances in technology. As a nation it is critical that we get on with the task of building this world-class broadband network that is so critical to our future.

CHAIR—Thank you. Does Mr Gallagher or Dr Warren have anything to add?

Mr Gallagher—No.

Dr Warren—No.

Senator MINCHIN—Could you start with what you understand when you refer to a national broadband network? You said that it was an upgrade of Telstra's network. Many people seem to be under the impression that it is a new network. I would like you to clarify what you are referring to when you talk about a national broadband network, and give us a bit of flesh on the bones of what you have in mind when you have talked about a national broadband network over the last three years.

Mr Quilty—You will understand that we need to talk in a general sense. In all likelihood this will be an upgrade of Telstra's copper network. In all likelihood it will involve putting fibre into that network and putting that fibre closer to customers' premises. It may be a fibre-to-the-node network whereby the copper between the telephone exchanges and the pillars, which people see in their streets, will be replaced by fibre in terms of the copper and pillars will be replaced by

intelligent nodes. Obviously it is a matter for the various proponents to decide what sort of network is built. In our case, it is highly likely that we will propose a fibre-to-the-node network. The government's RFP does not preclude fibre-to-the-premises networks.

Senator MINCHIN—It certainly talks about the objective being used as fibre-to-the-node or fibre-to-the-premises. It does not seem to contemplate anything other than that.

Mr Quilty—Without getting into the RFP in great detail, my understanding of it is that it sets a range of criteria of, if you like, objectives. It obviously indicates a clear preference for a fibre solution. It also indicates that in terms of the solution the government is seeking to roll it out nationally and has set a target or an objective of 98 per cent of the population. It has obviously also set minimum speeds of 12 megabits per second in terms of the downlink. Certainly there is a clear preference and it is one of the criteria, but I am not sure if there is an absolute preclusion of non-fibre solutions.

Senator MINCHIN—Are you suggesting that it is not realistic to roll out fibre-to-the-node to 98 per cent of the population?

Mr Quilty—I do not want to get into too much detail on that. Obviously in the capital cities you have a much denser population and previously, in terms of commercial propositions which we put on the table, propositions where we were not seeking any government funding, we indicated that with the right regulatory certainty we would be able to roll out into the capital cities. Obviously the government, as part of its RFP, has indicated that it is willing to make a capital investment of up to \$4.7 billion, so the question is to what extent can you meet the range of objectives, given the need for a company like ours to obviously make a competitive return for our shareholders and also the fact that the government itself has indicated it is willing to make the investment of up to \$4.7 billion.

Senator MINCHIN—What is your current estimate of the cost of a fibre-to-the-node network to 98 per cent of Australians giving 12 megabits?

Mr Quilty—Again, I do not want to be specific because of the RFP, but there are a number of cost estimates that have been put on the table, including by people from Telstra. It does vary and depends very much on how you want to do this. For example, one possible solution could be that you simply roll out what we call a best endeavours broadband network, whereby you simply replace the copper that at the moment is between the exchange and the node and you replace it with fibre and put in some nodes. However, I think there would be a lot of question marks in terms of such a network as to whether, firstly, it would be able to continue to provide the array of services that all Australians are used to today; secondly, whether it would actually provide the sorts of guarantees that everyone is after in terms of the minimum speeds; and thirdly, whether it would be upgradeable for the future. In terms of 'upgradeable for the future', we see that as absolutely imperative. To build a network now and spend billions of dollars on it and then to find out five years in the future that that network does not meet the country's needs, and not only does it not meet the country's needs but it cannot be readily upgraded because the architecture does not enable that to happen, would be a huge waste of both the company's resources and obviously the government's resources.

You can obviously start at that lower level of investment, which would cost quite a few billion dollars. Then if you move all the way through what we call a carrier grade fibre-to-the-node network, where you are able to continue to provide the array of services and provide them reliably, as well as provide the sorts of broadband speeds envisaged in the RFP and architect it so it is upgradeable in the future, you are talking about quite a few billion dollars more. If you then go to a fibre-to-the-premises solution and you roll out that solution in places where you have existing infrastructure, so they are not Greenfield sites, you are talking about tens of billions of dollars.

Senator MINCHIN—Is it realistic to roll this out to 98 per cent of Australia in five years as the RFP proposes?

Mr Quilty—Certainly that is the aim of the government, and in terms of us being a possible bidder here, that is what we are aiming for. That is one of their key criteria.

Senator MINCHIN—Your CFO said that was impossible. He said it would take at least eight years.

Mr Quilty—You mean in terms of the time frame?

Senator MINCHIN—Yes. The time frame says that it has got to be completed in five years.

Mr Quilty—We think it would be difficult in the time frame.

Senator MINCHIN—Do you stand by the figure of eight years that your CFO stated?

Mr Quilty—It depends. If you rolled this out basically 24 hours a day, seven days a week, then you can seriously reduce the time frame, but it needs to be recognised that we are talking about what would be the world's largest fibre network geographically. To give you a bit of a comparison, Verizon in the United States has passed one million customers and they have been going for nearly five years now with a fibre-to-the-node network. It is obviously a very challenging proposition.

Senator MINCHIN—Is it impossible?

Mr Quilty—I would not say it is impossible, but it is very challenging.

Senator MINCHIN—Does it remain Telstra's position that it will not lodge a bid by 26 November if the government does not rule out further separation?

Mr Quilty—Telstra's position is that if further separation is part of the NBN then we are not in a position either to build or to bid for the NBN. We have sought clarity from the government that further separation will not be required of Telstra as part of the NBN and we obviously have not made a final decision in terms of whether we will put in a proposal. We are seeking that clarity and that clarity is very important in terms of Telstra being able to do this project.

Senator MINCHIN—Have you formally written to the government?

Mr Quilty—We have.

Senator MINCHIN—Have you received a reply?

Mr Quilty—We have had a reply.

Senator MINCHIN—Can you indicate whether the reply gives you the clarity you are seeking or is inadequate?

Mr Quilty—The best way to put it is that we are still seeking the clarity that we need.

Senator MINCHIN—Could you quickly describe the current state of separation? As I recall, there is an operational separation requirement upon you.

Mr Quilty—Yes.

Senator MINCHIN—Can you give a brief description of what that is, how that operates and why you do not want to go any further?

Mr Quilty—We are currently subject to both accounting separation as well as operational separation. Tony can provide further detail.

Dr Warren—It is quite a complex beast and there is a lot in there. The key elements are firstly an obligation that we have separate wholesale division, a separate retail division and a separate network operating division, and that they be kept separate. There are certain obligations that adhere to each of those and their ability to interact. There are a whole lot of requirements on, for example, wholesale customer information. They clearly cannot go across and in any way be accessed by the retail arms.

They are the structural elements of the operational separation. The most potent and important parts of the elements are the reporting requirements. There is a whole series of matrices that are imposed upon us and that we have to report quarterly to make sure that essentially the operating part of the business treats wholesale and retail in an equivalent way. For example, we are testing on whether or not technicians, on average, fix up wholesale customer premises and retail customer premises on equivalent basis. Essentially, you measure the times taken once an order is put in the queue to fix a wholesale or a retail customer, and if there is any asymmetry or any discrimination then that shows up in the matrix.

Senator MINCHIN—Are these reports to the ACCC?

Dr Warren—The ACCC—

Senator MINCHIN—The ACCC is monitoring it?

Dr Warren—Yes.

Senator MINCHIN—Have you had any black marks against you in relation to that?

Dr Warren—No. There has been a clear finding from the ACCC each time these reports are given to them that there is no systematic discrimination. Just to be clear, occasionally you get overs and unders. Occasionally it does happen and the commission will ask us questions to explain that. It is not like they have got the reports, ticked them off and put them up. There has never been any concern.

Senator LUNDY—That is a good way to introduce my questions. As you are probably aware, we have taken evidence that customers seeking access to ADSL or ADSL2+ have been knocked back by Telstra in the first instance, and have ultimately been advised by their preferred carrier to sign up with BigPond and then transfer later. That seems to be the most effective way for at least some who want to be ADSL customers to get the service. We have taken evidence on that. In a way you have responded to that already in your answer to Senator Minchin, but I just wanted to hear clearly from Telstra what are the possible reasons that metropolitan customers would be knocked back when requesting an ADSL service, either through one of your competitors or indeed your own retail service? What are the barriers in your network currently?

Mr Quilty—As you know, ADSL is a distance limited technology. In terms of offering that technology we are only able to offer it effectively certain distances from telephone exchanges. This is one of the great benefits of the government's national broadband network. It is probably the most important benefit of all—that we will be moving from what are distance limited technologies where the speeds that end users get decline the further you get from the exchange, to a fibre environment where everybody in the footprint will be able to get a guaranteed minimum speed. The idea of haves and have nots will hopefully disappear. That is the case in metropolitan areas as well as in regional areas because people in the suburbs, as you know, suffer from those distance limitations and also in some cases are not able to get services because exchanges are full or there are various broadband blockers, as we call them, that are in place that do not enable ADSL. I think that is one of the critical reasons why an NBN is so important and why it should be proceeded with expeditiously. Tony may be able to add more in regard to the wholesale side.

Dr Warren—I have heard those complaints. They have obviously been raised with the ACCC as well and there have been quite extensive investigations into these issues. The first question is why someone in a metropolitan area could not get a broadband service and David has just alluded to the broadband blockers and so on. The more concerning question is can you get them if you go to retail, but you cannot get them if you go to wholesale. We have looked at this very extensively, and so has the ACCC. There is no evidence and no process reason why that would be the case. The systems are pretty automated now. You put the balls in, wholesale and retail, and they do seem to come out the other end in the same order in which they went in. I have to say that, whilst I have heard those concerns a lot, and we did investigate quite substantially because, as you have alluded to, that would be a competition problem if that was the case.

Senator LUNDY—Yes. It would be a breach of the Trade Practices Act.

Mr Quilty—We have architected our system so that is not the case, but you have got to always test these things. I have to say the commission and ourselves have looked very rigorously at this and have not found supporting evidence of those concerns that have been raised. These systems are never perfect and people should always raise those concerns. As I said, it is easy to raise those allegations, but we are finding it much harder to substantiate them.

Senator LUNDY—You have identified three issues that could prevent metropolitan and some regional customers from getting ADSL. With the distance limitations, my experience is that it used to be a general four kilometres, depending on the quality of the copper from the exchange. We have heard evidence in Perth last week that, depending on testing the line, those distances could go a great deal further or indeed a little bit further. To what extent do Telstra test the line on behalf of customers before making a decision whether or not that potential customer qualifies for an ADSL service from a given exchange? Does that depend on the local technician or what is the policy?

Dr Warren—No. It is a service call.

Mr Quilty—It is a service call based on continuation. The actual line testing is part of that.

Mr Gallagher—There is not a physical test. It is tested by reference to information that sits in various databases.

Senator LUNDY—It is essentially a map.

Mr Gallagher—We do not ping the network to send something over it to see whether or not the ping gets there.

Senator LUNDY—I am interested in your point about exchanges being full. We have had issues raised through the course of this inquiry about what constitutes full or not. I understand that there were a large number of exchanges that were previously classified as full, were looked at by Telstra and then not classified as full. How do you classify an exchange as full and what does that mean for other competitors trying to install DSLAMs in your exchanges?

Dr Warren—This is a big issue in terms of the industry debate. It is an issue that actually jumped out from nowhere. This was not an issue that was causing any concern. Wholesale had a list up of full exchanges and those were exchanges in which there was no physical space for access seekers to put their own equipment. We had a list up and it started to raise its head as a concern in the industry. We did a detailed audit of those exchanges and the capping rules, and as a result of that we went to the commission. Let me hasten to add we did this off our own bat. We saw the issue rising so we decided to have a closer look at it. As a result of that we took 20 to 30 exchanges off the cap list. I do not have the exact numbers in front of me. We are talking about 5,000 exchanges here. At the moment it is something like 15 to 18 exchanges that are capped. These are exchanges that are relatively small physical exchanges that are in very tight metropolitan areas. As a result of that audit, and the fact that there were clearly things that should not have been on there that were on there, we changed our process. We now have a much more senior oversight process. We demand a physical inspection, rather than a plan based inspection, which seems to be where some of the problems crept in last time. I hear about this all the time at conferences and so on, but I would assure you that there are very few capped exchanges in the network now, the processes around it are very rigorous and we have walked the ACCC through that.

Senator LUNDY—Could you provide the committee with a list of the capped exchanges?

Dr Warren—I can provide the committee with a website that has got them, but we can give you a list as well.

Senator LUNDY—That would be useful. I would like a quick exploration of broadband blockers or various types of pair gain systems. I have asked a few questions of Telstra through previous inquiries about these issues. The last time we had a close look at it through a previous Senate inquiry there were some 1.2 million pair gain systems—large, medium and small—in the Telstra network. Is that still the case?

Mr Quilty—1.2 million.

Senator LUNDY—1.2 million of your services were delivered through one type or another of a pair gain system, which had the effect—at least back then—of effectively blocking ADSL. I should say that a proportion of those pair gain systems no longer block it because of new technologies but provide a limited number of services, for example, through the RIMS. I just wanted to get some confirmation that there are still pair gain systems in the system and there is not a program of systematic removal of those pair gain systems?

Mr Quilty—Over the years we have removed a deal of them, particularly the larger ones. Where it makes commercial sense we consider removals. In terms of the number that you have indicated, it does sound a little higher than what I think is the case. In terms of the percentage of the population in ADSL enabled exchange areas that would not be able to get ADSL, it does seem somewhat high.

Again, I would go back to the point that this is a key reason why we really want to get on with the NBN. With the investments you have in these systems, it makes sense to make a major investment in terms of upgrading the network rather than going in individually and seeing if you can fix particular pair gain systems when the prospect of a major upgrade is there. It is one of the reasons why we welcome the fact that both sides of politics want to upgrade the copper network. It is one of the reasons why we are not able to effectively serve customers with the sorts of broadband we would like to provide, and obviously wholesale customers are not able to do so, either.

Senator LUNDY—My understanding of pair gain systems replacement is that it is more the small to medium size pair gain systems that you have been replacing, that is the rural ones, when they break.

Mr Quilty—Yes.

Senator LUNDY—Also you are able to transpose small pair gain systems, the single pairs or two by fours, on request. I wanted to ask you specifically what a customer has to do to request what is called a transposition to have a small pair gain system removed from either the pillar or their home in order to facilitate an ADSL connection, and what Telstra's policy is to make that decision to spend the money to transpose their line to facilitate an ADSL connection?

Mr Quilty—I would have to take that on notice.

Senator LUNDY—I would appreciate if you could do that. I still get constituents through my website saying, ‘I can’t get it up. I’m told I’m on a small pair gain system. What do I need to do?’ I know Telstra, in the past, have made commercial decisions to transpose the line, which is basically rolling out some new copper to facilitate an ADSL connection. The feedback I am getting is that Telstra are currently using the excuse that it is not commercial. They are using the fact that this tender is out there as a reason not to do anything. It is an important question if these problems can be fixed relatively cheaply and quickly for constituents who would otherwise be currently connected to ADSL. It is a practical problem and I am taking this opportunity to bring it up.

Dr Warren—Just to add to what David said, that is absolutely the reason why. If we talk about a carrier grade NBN, we are talking about end-to-end. There is not much point doing fibre-to-the-node if there remains between the node and the CPE a whole lot of pair gain systems.

Senator LUNDY—That is right.

Dr Warren—You would basically need an end-to-end solution.

Senator LUNDY—The prospect of an NBN ought not to change a decision within Telstra at the moment about whether or not to transpose a line to facilitate an ADSL connection.

Mr Quilty—You are talking about operationally whether do you, with the prospect of what would be a very significant fibre and copper piece of work—let us not forget that if you are going to do this properly not only do you have to put the fibre in, but you are going to have to make sure that the copper is of the grade to enable the data to get through—to set up a workload where you do it incrementally in terms of small numbers of lines when you are likely to be coming through and doing a very significant whole-of-network upgrade may not make sense.

Senator LUNDY—I appreciate that, but if it is an upgrade that would have to occur under NBN anyway, remembering the fibre is only going to say the pillar or the node, then that original copper is still going to be used. It is not a dead investment in that regard and you could facilitate a small business getting a broadband connection for the next six, 12, 18 months or however long they have to wait for NBN.

Senator MINCHIN—About eight years.

Senator LUNDY—That depends on who you talk to. Do you see my point?

Mr Quilty—I understand your point. The question is whether it does make sense, both commercially and operationally. The other thing is that ADSL is not the only means by which households and small business can have access to broadband.

Senator LUNDY—That is the answer they get; they are told to buy the mobile data service. That is the response that these constituents are getting from Telstra.

Mr Quilty—That is one, or if they are in the HFC footprint. There are other options around. We will certainly get the policy to you in terms of transposition of pair gains.

Senator LUNDY—Can you also tell me what your policy is for transposing lines at the request of another carrier that comes to Telstra, so essentially a request to transpose a line through wholesale?

Mr Quilty—Yes.

Senator LUNDY—You mentioned 5,000 exchanges. That is 5,000 plus. Can you tell the committee how many of those exchanges are in fact ADSL enabled and how many are ADSL2+ enabled?

Mr Gallagher—That is something we would have to take on notice. I do not know the exact numbers.

Senator LUNDY—Last time I looked, which was a few years ago now—so I expect it to be many more—it was around 1,000.

Dr Warren—One thousand?

Senator LUNDY—It was 1,000 some time ago. I would expect it to be higher than that.

Mr Gallagher—I think it is 2,500, but we will get the number.

Senator LUNDY—About half of Telstra's exchanges are currently ADSL enabled.

Mr Quilty—I think about 92 per cent of the population lives within exchange areas that are enabled with ADSL, and of those close to 70 per cent live in exchange areas that are enabled with ADSL2+.

Senator MINCHIN—Is that 70 of 92?

Mr Quilty—Yes.

Senator LUNDY—I am glad you expressed it like that because most people express it as 92 per cent and 70 per cent are ADSL enabled, which is not the case. What percentage of customers, on average, running off an ADSL enabled exchange are actually connected to ADSL?

Mr Quilty—Do you mean how many are connected or how many are able to get the full speed benefits?

Senator LUNDY—No, how many are connected?

Mr Quilty—Obviously whether you are connected depends on whether you as a customer seek to be connected.

Senator LUNDY—I understand that. My next question is: what is the capability of that exchange, given the space constraints, which I presume are real and determine whether the exchange is capped or not in some cases, and also the distance and pair gain limitations?

Mr Quilty—They are two separate questions. The way I like to put it is that in terms of those exchange areas which are ADSL enabled, less than 50 per cent of the customers—the households and businesses—in those exchange areas can get the full speed benefits that ADSL would provide. Primarily, that is due to the distance limitations. To an extent, it is also due to the other matters that you raised. I would hesitate to guess, but in terms of those other matters it would be less than 10 per cent. Again, the fundamental point here is that ADSL is distance limited and it is also a ‘best endeavours’ broadband solution. If you read the small print in your contract it always says ‘up to eight megabits’ or ‘up to 20 megabits’ if you take the full speed, whereas if we move to a network where fibre is pushed to the node there is the ability to provide guaranteed speeds. I think that is a fundamental proposition in terms of delivering the sorts of value added services that everyone is going to take for granted in a decade’s time.

Senator LUNDY—Thank you.

Senator NASH—One of the concerns for the committee has been that so many of the submissions have put to the committee that if there is not structural separation then Telstra will be a monopoly. Why do you think so many witnesses have put that view forward to this committee?

Mr Quilty—Because it is in their interests.

Senator NASH—In their interests?

Mr Quilty—Yes. The fact of the matter is that if others can convince the government to structurally separate Telstra, what they are simply proposing is to weaken Telstra. Telstra’s ability to use its assets, which are obviously integrated to provide services to customers, would be undermined. It is simply an argument of commercial convenience.

Senator NASH—When you say ‘they’, who do you mean?

Mr Quilty—Certainly in terms of competitors. There is another group of people.

Senator NASH—My question is much broader than that. I understand your view from those competitors, but there are a number of submissions that have come from people who are not your competitors and who still hold that same view. Taking that competitive aspect out of it, why do you think that particular group would have the same view? They have nothing to gain from structural separation.

Mr Quilty—I think it is one of the great urban myths that has been around for nearly 20 years. It was one of the economic theories taught at Australia’s pre-eminent universities in the late 1980s. The world has moved on since then in terms of telecommunications. Obviously, to start with, Telstra is no longer an inefficient government enterprise. We are obviously a commercial operation.

In terms of networks, how they are comprised and how they work, the sheer complexity involved with respect to the systems, platforms, the IT and the applications that run over them is like chalk and cheese with respect to where things were at 10 or 20 years ago. I never hear from

anyone who is a proponent of structural separation about how you do it and how, when you do it, you would also build a world-class national broadband network.

Senator NASH—Given the comments you have just made, would you say that those people who do have the view that you should be structurally separated are misguided and ill-informed?

Mr Quilty—I would never call anyone misguided. I am not sure if they would have an in-depth understanding of how modern telecommunications is delivered to end customers.

Senator NASH—Given that we have not got any kind of concrete arrangements from the government in terms of what they see the regulatory environment becoming—the regulatory certainty that you keep calling for—all of those people who make those comments about structural separation can only gain comfort from the fact that Telstra says that it is committed to open access and infrastructure competition. At the end of the day the only thing that is going to make that happen, apart from the very goodwill of Telstra, is a regulatory environment. We have not got one in place yet that is going to necessitate that. Do you understand why people are perhaps a little nervous about Telstra's ability to potentially be a monopoly, if indeed you bid and if indeed you are the successful bidder?

Mr Quilty—The idea that Telstra is a monopoly is another one of the urban myths.

Senator NASH—No. I did not say there is a monopoly. I said potentially a monopoly under the new arrangements.

Mr Quilty—When you look at the facts, to claim that suddenly Telstra might become a monopoly under the new arrangements makes no sense at all. In terms of delivery of services in this country, we have got the fixed copper network, which Telstra owns. That is a highly regulated network. Obviously there is open access to a wide array of services, which is obviously overseen by the ACCC. In terms of the NBN there will obviously be open access to an array of services which would hopefully in some way be locked in by the government and would be overseen by the ACCC. Not only that, you obviously have two cable networks in most of the capital cities. You have four wireless broadband networks. Telstra has a footprint of 99 per cent, Optus is going to 98 per cent and Vodafone to 95 per cent. You have got 400-plus ISPs out there competing. You have got satellite providers. Whatever service you want in this country, there is an array of providers to provide it over an array of networks. I think that the idea that somehow Telstra might become a monopoly does not stand up when you look at the facts. Obviously with this network Telstra has made a strong commitment to open access.

Senator NASH—Nice try, but there will only be one fibre network to the node. I understand all your comments about the other providers, but there will only be one fibre because it would be stupid to build two. Regardless of whether it is Telstra or not, whoever owns that does have a potential monopoly unless the regulatory environment is there to ensure that that does not happen. My question is: what is it that Telstra would like to see from the regulatory environment? What is your view of what it should be, and in that regulatory environment how can competitors take comfort from what you see that environment should be that they will get fair and open access?

Mr Quilty—I will pass to Tony in terms of the regulatory environment. Simply because there is only one of a particular type of network when there is an array of different networks that are available to provide services, and in terms of that one particular type of network, if the provider is committing to open access how that would be perceived to be a monopoly is very difficult for me to understand.

Senator NASH—If all those other networks are just as good, then why are we building a new one?

Mr Quilty—The fixed network is one of the ways in which people get services. It is not, at this stage, taking advantage of the sorts of technological advances that are available around the world. There is a major investment opportunity to provide significant improvements in these services and to set up this nation in terms of a high-speed broadband future. I tend to try to look at these things as the glass is half full. It is a critical investment for the country. As long as you do it right, as long as you do it in a world-class way, and as long as you do not do it in a way that stifles competition, that has got to be a good thing for everyone. Others obviously look at the glass being half empty, but as a nation we will get a lot further if we encourage investment and if we put in place the infrastructure that will enable innovation, that will enable people to be more productive and the like. I am quite excited about it. I just want it to start.

Senator NASH—I am a glass half full person myself.

Dr Warren—I am a regulatory person, so I am a glass half empty. In fact I do not think there is a glass. There are two things. One is on this idea of infrastructure competition, which is the point you made. There is no doubt there are parts of Australia where there will not be infrastructure competition from another fixed network. There have been international evidence and comments from people like Martin Cave who is a bit of a regulatory guru. He had a nice quote, which is, ‘The only way you will ensure that it becomes a monopoly is if you regulate it like it is one.’ I think that is a good warning to us. If you look at places—not just the US, which is the archetype—like the Netherlands and other places like that you are seeing a cable copper speed war and investment war. That is quite important.

Going back to the point you are making, we understand this and it has been part of our proposal since the beginning. It has to be an open access network and that open access has to have real meaning, it has to be policed and ensured. Access seekers need to be able to come along and accept that they are going to get the functionality they need to take this forward.

Let me give a bit of colour on that, as the analysts would say. There is the physical pipe and that is the NBN. It is just a fat pipe. What people will do at both retail and wholesale is use that fat pipe with their own additional investments to provide everything from best efforts internet through to streaming IPTV and HD IPTV. There are quite a lot of things that you can do. The critical thing is that the wholesale and retail customers get access to that underlying pipe on an equivalent basis.

Senator NASH—And of course at reasonable cost?

Dr Warren—Yes. We are on that. We have talked about locking in wholesale prices for the lifetime of the investment and we are very clear there has to be a reasonable margin between

retail and wholesale. We understand that. This thing cannot fly as a closed network. There are closed networks around the world and people are relying on infrastructure competition, but we have been very clear that this has to be an open access network. We have spent a lot of time working out how you can get that pipe access with the flexibility so that access seekers can innovate and are not just locked into our product road map, if you like.

Senator NASH—Telstra may or may not put in a bid. If Telstra is not the successful bidder, what is Telstra's view and what is the process for the copper that Telstra owns and will continue to own between the node and the home if somebody else is going to be a successful bidder? What would Telstra's view be about the access and process for somebody else to utilise that? Without that, of course, they cannot run a new network.

Mr Quilty—Firstly, that is a hypothetical question. Secondly, it is really a matter for somebody else in terms of what they propose. You may be aware of a term called 'subloop unbundling', which has various meanings. The meaning that it seems to have in this country, as far as a group that was previously known as the G9 was concerned, is that it involves the wholesale cutover of all Telstra's copper lines at the node to somebody else's network.

In terms of the engineers and people in Telstra who have built networks all around the world, they tell me that such a proposition of the nature that was proposed last year by this G9 group has never been attempted anywhere in the world. They also tell me that if it was attempted it would cause massive difficulties in terms of ensuring the reliability of services and the fixing of faults. There would obviously be a fracturing of the ability to provide end-to-end services over that network. There are all sorts of issues that such a proposition would have to take into account of the copper itself. As we indicated, if you are going to run a world class network then you need to make sure that that copper can facilitate the data you want to run down it. It is not simply a matter of cutting over the copper holus bolus as it exists now and then saying that as a result we are able to provide a guaranteed minimum speed, let alone continue to provide the sorts of everyday services that people get on the network now. It is up to others, but we are more than sceptical about such a proposition.

Senator NASH—In layman's terms for we mere mortals who do not have your level of knowledge of all the mumbo-jumbo, if currently Telstra have the copper between the node and the home and assuming that that copper will carry whatever is needed currently, if you are going to put the fibre into the node and your proponent X has been a successful bidder and they need that bit of copper or indeed the availability to put something better in next to it—but let us just say that copper would actually hold up—would Telstra give access to a successful bidder that is going to need that copper?

Mr Quilty—That is entirely hypothetical.

Senator NASH—It is entirely hypothetical.

Mr Quilty—We are focused on having in place an environment that will enable us to build this; we are not thinking whether in some hypothetical world we might provide access to our copper loops to somebody else.

Senator NASH—Absolutely. In this hypothetical world that little piece of infrastructure may well be needed by a separate bidder. If that particular bit of infrastructure cannot be accessed by an alternative bidder then they are not going to be able to run a whole network to somebody's home. I am trying to understand the process or arrangements that if you are not the successful bidder how is an alternative successful bidder going to be able to utilise that bit from the node to the home if it is infrastructure that you own?

Mr Quilty—They obviously have to either interconnect with our network in some way, maybe where you are saying, or they have to build, if you like, their own last mile as we call it. They may decide to build a fibre-to-the-premises solution. There are companies that provide those sorts of solutions now.

Senator NASH—They might decide to build, or they might have to build? Would you rule out saying no, you are not going to give access on that particular bit of area.

Dr Warren—The problem is not refusal of access, but one of uncharted waters. As David said before, it would be a wholesale cutover of loops, including loops we use to service our end customers. What they have to do is chop a loop we are using to serve a customer, put it in the back of their DSLAM and then resell it back to us, and then in some way maintain complete control of the quality of service and the entire network and so on. It has never been done anywhere in the world. It is not a matter of refusal to supply. The regulatory tools are clear. What we are saying is no-one knows how you do this in practice. People overseas scratch their head at the G9 proposal, because they just ask, 'How does that work physically?' It is not us saying, 'You can't come here.' That is not really the nature of the question. The nature of the question is: how do you actually do it technically and make the whole thing work, so that 000 is working and so that traffic lights are working, to use a topical example. It is a very good question, but not one for us I do not think.

Senator NASH—I would say that it is well and truly going to be one for you.

Dr Warren—It is one for us to provide a solution to.

Senator LUDLAM—I would like to go back to the comments you were making before about the fat pipes. It was memorably described as a system of tubes. Would you agree with the idea that a national broadband network, similar to power and water infrastructure, is in fact a natural monopoly?

Dr Warren—No. I would say that in places there is a natural monopoly element to it. There are clearly some geographies where it has natural monopoly characteristics. It depends on whether or not you include wireless as a competitor. Putting that aside, there are lots of examples from many places around the world, and indeed here in the ACT, where an alternative fibre network can sit side by side. That is quite clear.

Senator LUDLAM—Would it not be the case with moving to the fibre-to-the-node architecture that the nodes are physically a lot smaller than the exchanges which competitors are currently able to add competing hardware to, and that in moving to this architecture it does make it more difficult to physically have two, three or more networks competing and operating side by side?

Dr Warren—I need to clarify that I was referring there to full physical infrastructure competition, something like the TransACT HFC network or the Optus HFC network. What you just said is absolutely true. At the moment competitors put their own equipment, their own DSLAMs, in our exchanges and take the copper pair out to the home. There are 5,000 exchanges, but there are about 1,000 exchanges that are big enough for competitors to make economic sense to do that. If you then put nodes out the number of places where they would have to put their own equipment goes up exponentially. Therefore, the economics of ULL is decimated. ULL, unbundled local loop, and next generation networks, like FTTN, are two different worlds.

Senator LUDLAM—I am not altogether sure whether you are agreeing with the proposition that moving to a fibre-to-the node architecture essentially removes the hardware component or that fibre backbone from being part of the competitive field, that what we are building here is something that is not only difficult to duplicate, but it would be unnecessary and we would not want to do that.

Dr Warren—Yes, okay. Putting aside the unbundled local loop and subloop issues that you are talking about there, it is very clear from the evidence we have around the world that in large urban areas it is not only possible but it is likely that you will see competing fixed broadband infrastructure.

Senator LUDLAM—Could we see in Australia more than one national broadband network?

Dr Warren—Not national. I said in certain areas you will see it. It is more than likely that you will see competing fixed high-speed broadband networks. A cable network and an FTTN network side-by-side is a very common pattern around the world.

Senator LUDLAM—Are they delivering much the same services or differing services?

Dr Warren—That is the beauty of infrastructure competition. Unlike ULL based competition, which is essentially people delivering exactly the same service, you will see real differentiation. If you go to the UK you will see Virgin Media, which is the cable company, having these quite witty ads about copper being good for plumbing but it is not good for broadband. They are really trying to distinguish the FTTN type copper networks, copper and fibre, from the HFC networks. The other way they distinguish themselves is through triple play. The HFC networks are better at broadcasting than the FTTN network. You do see quite a lot of differentiation going on, but it is all around delivering high-speed broadband networks.

Senator LUDLAM—I do not want to get hung up here, but I am trying to pursue the line of argument that Senator Nash was pursuing, which is that most people who have given evidence to us over the course of this inquiry have said that the owner and the operator of the physical hardware underlying the national broadband network will be operating effectively as a natural monopoly. It is the argument around structural separation: we do not want the owner of that network to be also offering retail services while competing with other retailers.

Mr Quilty—The critical point here is the commitment to open access.

Senator LUDLAM—We have heard a bit about that. Can you explain briefly what Telstra means by open access? That is another proposition that was put us that there are some different interpretations of that.

Mr Quilty—What we mean by an open access network is that Telstra or whoever—presumably us—builds the network and presumably commits to open access and would make available to wholesale customers a range of wholesale products on an equivalent basis. If there is any perception of a natural monopoly, that is effectively rendered irrelevant because the network will be open; the platforms will enable the equivalent delivery of those wholesale products to all those who seek to purchase them. I cannot go into the detail of what those products might be. That is one of the fundamental questions in terms of the RFP.

The other point that Tony touched on, which is critical, is that what we have here is a real opportunity to have a competitive open access regime that actually works effectively and delivers true equivalence to wholesale customers, regardless of who they are.

Senator LUDLAM—As a competitor would I have recourse to the ACCC if I felt I was not getting a fair go?

Mr Quilty—We certainly envisage this. Let me say that in terms of the regulatory regime, we presume that there will be requirements regarding open access that would be agreed by the winning proponent and the government. They would be locked in in some way, possibly through legislation or possibly through legislation and a combination of various undertakings. We envisage and have no difficulty with all of that being rigorously enforced by the ACCC. We have not said we have a difficulty with the whole array of other requirements on Telstra to ensure there is equivalent, transparent and non-discriminatory treatment continuing. That includes the operational separation regime that exists at the moment.

Senator LUDLAM—Can we just pause there? We saw the ACCC earlier in hearings that we conducted. I regret that I do not have the original transcript in front of me, but they mentioned that the largest part of their caseload was litigation brought by or against Telstra. It was a huge part of their caseload. They said that Telstra has in fact taken—these are not their words, but mine—a very litigious approach to the way that they were being regulated by the ACCC.

Mr Quilty—Yes. There is no doubt that we are in a sector where there is a significant amount of disputation. To be quite frank, as the person who has to look after the budget from which this disputation comes, we are as sick and tired of it as everyone else. In terms of moving to a national broadband network, we are actually building the platforms so that they are open platforms. We are not trying to bolt on wholesale services to a copper network which was built at the start to be a retail-only, monopoly network. We are building an open and competitive access network from day one and we are locking in the sorts of wholesale products which will enable everyone to innovate and provide an array of services that will significantly reduce that disputation.

Senator LUDLAM—It looks to an outsider, like myself, to the industry as though Telstra has the regulator tied in knots, that there is just a massive amount of disputation and arguing essentially with the umpire. I draw your attention to a report that you are no doubt aware of. The ACTU Corporate Research Unit issued a report that cautioned Telstra senior management on the

dangers of what they described as a combative and litigious approach to the NBN and outlined a number of quite significant risks to the company. What was your response to the cautions that were offered in that report?

Mr Quilty—I have read that report. The bottom line for us is that we have to act in the interests of our shareholders. We cannot do anything that we do not consider is in the interests of our shareholders. There is no doubt in the mind of Telstra management, and all of the analyst reports concur, that further separation of Telstra is not in our shareholders' interests. We simply cannot contemplate it.

Having said that, obviously I think the claims by the ACTU that we are taking a combative approach to this are somewhat over egged. Our primary proposition is that we want to get on with it. We need this clarity in terms of this fundamental issue but, once we get that clarity, we would like to put in the very best bid and give ourselves the best opportunity to do this important job.

Senator LUDLAM—Maybe the glass looks more like it is half full if you own the glass.

Mr Quilty—And maybe there are some other industrial issues that might be involved with the ACTU's paper.

CHAIR—Mr Quilty, you talked earlier in response to Senator Minchin about providing upgraded services to 98 per cent of the population. What is Telstra's view of what the 98 per cent will look like? Who will be in it? What will be in it?

Senator MINCHIN—More to the point, who are the two per cent that miss out?

CHAIR—Can I ask about the 98 per cent first?

Mr Quilty—That question does go fairly close to the RFP. In terms of what comprises the 98 per cent—Bill, correct me if I start to go outside my remit—there are obviously various mapping techniques in terms of understanding Australia's population and my understanding is that we are talking about premises. Is that right?

Mr Gallagher—Yes.

Mr Quilty—We are talking about 98 per cent of addressable premises. Is that correct?

Mr Gallagher—It will be premises with a service. There are various databases that show the existence of, for example, a spare piece of land. We will not be counting service addresses unless there are actually premises there.

CHAIR—In saying 'addressable premises', you mean premises with a postal address, or addressable in terms of redressable?

Mr Quilty—It is not premises where there is nothing there.

Mr Gallagher—Or post office boxes.

Mr Quilty—Bill, correct me again if I am wrong, but this is throughout the period of the NBN and, as you know, Australia's population is continuing to increase.

Dr Warren—Isn't another way of answering that question that it is to go to the two per cent because it is the non 98 per cent. What is most likely to put someone in the two per cent is that they are a long way from an existing exchange and they do not have many neighbours. There will be people who are a long way from an exchange who have lots of neighbours and therefore could easily be served by a node. I do not know if this goes to your question, but it seems to me if you are thinking about the kind of people where a fibre based solution is going to be very difficult, they essentially need a node all of their own, or where they have only got one neighbour so it is just one node between the two of them. These nodes are quite expensive and it is expensive to get the fibre out there.

It is interesting. People think about who the two per cent will be only in the middle of the Tanami Desert. It may actually be people on isolated mountains and there might be communities in what we would consider to be quite remote areas that would be included in the 98 per cent because there is sufficient density to make it sensible within the overall framework to use a fibre based solution. Does that help?

CHAIR—When would a tenderer know who is in and who is out?

Mr Quilty—It is a matter for the tenderer to put forward a proposal to meet the criteria.

Dr Warren—Do you mean a customer or a tenderer?

CHAIR—Tenderer.

Mr Quilty—It is up to the tenderer in terms of how they would meet that criteria or to the extent to which a proposal would, there are no pre-stipulated addresses.

CHAIR—Is the 98 per cent achievable?

Mr Quilty—It is one of the criteria, as is the objective of rolling out fibre, or the preference for fibre. Obviously we are working that through. I would say that it is a difficult objective but I would not classify it as you have or as unachievable.

CHAIR—Difficult, not necessarily unachievable. Thank you.

Senator BIRMINGHAM—Picking up on that for a moment, is it difficult but made more difficult if you are pursuing a fibre-to-the-node network, rather than looking at a network that may be a mix of technologies?

Mr Quilty—That starts to go to the RFP. I am not necessarily sure that is a cut and dried yes or no, anyway, even if we could answer it. One of the things that people need to realise is that, regardless of whether you have a fibre solution or whether you have a wireless solution, which is obviously one of the alternatives, getting the infrastructure out there, the backhaul transmission, is a very significant proportion of the cost, and you need to have that regardless of what the last mile is.

The previous government had an alternative solution to get out to rural areas and a very significant proportion of the cost of that was actually the transmission rather than the wireless towers. People need to be somewhat careful in terms of thinking that if we did it using something other than fibre it is suddenly going to become a matter of many degrees cheaper.

The other point is Tony's point, which I think is a very valid one. It is the case that you really need to go and look at the characteristics of individual villages, towns and even individual premises, in terms of understanding the best way to deliver a broadband service of the type envisaged by the government. There are a significant number of pretty small rural towns of say 200 premises that will have exchanges and most people will live within a very short distance of those exchanges.

Senator BIRMINGHAM—I will come back to the backhaul costs if we have time. I will stick with mapping for a moment. Are you confident that the mapping methodology to translate what the 98 per cent of premises are would be a methodology that is compatible with that used by the department?

Mr Gallagher—I am not sure the department has specified what the mapping methodology is. The RFP simply has an objective of reaching 98 per cent. It does not go on to specify how you measure that 98 per cent. That is a matter for proponents to put forward in their proposals.

Senator BIRMINGHAM—The department has indicated in estimates questioning and elsewhere that they have their own methodology that they apply. Similar methodology has been used in relation to the OPEL contract in the past; there are different versions, of course, as to whether that was a factor in the unravelling of that contract, but nonetheless it is at least a point of dispute in the unravelling of that contract. Terria, when they appeared before this committee—so it is public evidence—indicated that they had sought some comfort as to what the methodology was for 98 per cent. At that stage they had not received a reply. Are you aware of whether a public disclosure under the RFP has been made or have you pursued any such concerns yourselves?

Mr Quilty—That obviously goes directly to the RFP. All I can say is that under the RFP there is the ability for proponents to seek clarifications. Those clarifications are a matter for the NBN taskforce with respect to how they respond. You asked if they are public. I am not aware that those clarifications are public.

Senator BIRMINGHAM—Some of the early ones were. I am not sure now.

Mr Quilty—Yes. They are usually provided to all proponents equally so everyone is treated fairly. That is the mechanism, if you like, where people have issues or questions with respect to getting them answered. I am certainly not at liberty to reveal the extent to which there might have been a clarification sought or received, because that would go to the heart of the RFP.

Senator BIRMINGHAM—I will flick back to Senator Minchin's questioning earlier on in relation to the clarity that you might be seeking around structural separation. Just so I can get some clarity, is the position of Telstra that you need to receive that clarity before 26 November in which to lodge a bid? I am obviously looking at the comments of the chief executive in that regard. You said, 'Before we bid we need clarification.'

Mr Quilty—Yes. The position is that if further separation is part of the NBN then we are not in a position either to bid or to build. We are seeking clarity as to whether it is or not. The fact of the matter is that further separation is not a requirement, and that has been made clear publicly by the minister. In effect, what we are asking for is confirmation from whoever might be willing to give it to us that, given that further separation is not a requirement, it will not be required of Telstra. That is the clarity we are seeking. The reason we are seeking it is that in putting together the economics of building this thing and working out how operationally you would actually do the build and how you would maintain it, we simply cannot do any of those things unless we are operating as a fully integrated carrier.

Senator BIRMINGHAM—To be very clear here, is the receipt of that clarity a pre-condition of you physically lodging a bid on or before 26 November?

Mr Quilty—That is a matter at the end of the day for the board to take a decision on. However, as you have indicated and as our CEO has indicated, we need that clarity. In his view, we need that clarity in order to proceed with the bid. At the end of the day the board has to come to a decision and it will come to that decision obviously at the time that the bids are due.

Senator BIRMINGHAM—Are there any other regulatory issues on which the decision to make a bid or not hinges in terms of clarity from the government?

Mr Quilty—No. I would not say there are any other regulatory issues that require clarity. Obviously if we do put in a bid we will be seeking the sort of regulatory certainty we need to give us confidence to invest the capital required. We highlighted the sorts of areas where we need that certainty in our regulatory submission, but in terms of the issue of going forward with a bid, there are no other regulatory matters.

Senator BIRMINGHAM—In a regulatory sense there are preconditions that would potentially see a bid that Telstra made stay on the table right through the process, or in the end if the government came up with a framework that was unacceptable the whole pack of cards could come tumbling down. I am sure that would be the case for any bidder, so I am not necessarily looking to explore the specifics of that, but I want to get to the process of it. Is Telstra comfortable with the process in which the regulatory framework for this is being developed, and particularly the way it is being developed in tandem with the bid process?

Mr Quilty—That is an interesting question. The fact of the matter is that the process that is before us is the process, whether we could think of a better process or not. As far as I am concerned, I am of the view that reform of the regulatory regime is very overdue in this sector. The current regulatory regime discourages investment. My preference would have been—though clearly now it is not the case—that significant regulatory reform should have been undertaken a number of years ago. It would be hypocritical of me to indicate that the regime when it was put in place did not have laudable objectives, but the world has moved on significantly since then and I think the regime is grossly outdated.

CHAIR—Senator Birmingham, I note that it is almost 8.30. We were scheduled to sit until 8.30. The committee is very much benefiting from Telstra's evidence, so are you willing and able to sit with us until quarter to nine, so an extension for 15 minutes?

Senator BIRMINGHAM—Yes, of course.

CHAIR—Thank you.

Senator BIRMINGHAM—What are your expectations of the dialogue that you will have with the government on the regulatory framework post 26 November?

Mr Quilty—Obviously whatever dialogue happens presumably depends on whether you put in a proposal or not.

Senator BIRMINGHAM—We will pre-suppose that you do.

Mr Quilty—Bill, if I say something that is not right, strike it off the record, but the process as I understand it is that the expert panel appointed by the minister will consider the proposals post-26 November for a period of eight weeks or something like that and then they will report to the minister. Presumably the minister will then make some sort of a decision. The process with the expert panel will be ‘enlightened’ by the ACCC in terms of the regulatory regime and obviously the regulatory asks will be taken into account as one of the criteria that will be weighed up as part of the recommendations that the panel will make to the minister. My presumption is that the involvement of the proponents in that process will be a matter for the government and the panel.

Senator BIRMINGHAM—Would there be benefit in Telstra or other stakeholders having an opportunity to respond to particularly the ACCC’s proposals that they may put back to the expert panel?

Mr Quilty—I think there would be, yes.

Senator BIRMINGHAM—In terms of the final regulatory framework that the government may choose to adopt, do you think there would be benefit in Telstra and other stakeholders having opportunity to at least respond to that in some format prior to the ink being put on the page with the bidder?

Mr Quilty—We all envisage that in terms of the regulatory framework it will involve some legislation, if we get to that stage. There will be a legislative process and we obviously understand that. My other point is that we just want to get on with it, once we get the clarity. Obviously there needs to be due process, but we think that the critical thing now is to get on with the job. Regulatory certainty is part of that, but obviously open access is another core part of it. We recognise the legislative process and the length of time it will take, but our wish is that win, lose or draw this issue be resolved.

Senator BIRMINGHAM—There are a range of other things that I could do, but I am mindful of the time we have. I have a question that you may be able to answer or may wish to take on notice. You have stated and made it fairly clear in your submission to this expert panel and elsewhere that the building of an NBN in metropolitan major regional centres is a commercially feasible thing and that in the right regulatory environment would have occurred regardless of government investment.

Mr Quilty—That is certainly the case in the major capitals and potentially in larger regional centres. That was a proposal that we have put up previously on a commercial basis, without government funding, as long as we got the regulatory certainty.

Senator BIRMINGHAM—Do you have an estimation of what proportion of premises that might have covered, what proportion of premises are commercially feasible?

Mr Quilty—I am not sure.

Dr Warren—It is fair to say that the five capital cities constitutes just over 50 per cent of the population. If you looked at the proposal that we put out before, the five capital cities, including the Gold Coast which is part of the Brisbane-Gold Coast corridor, constitute over 50 per cent.

Mr Quilty—The other point I would make is that since we put forward that proposal obviously times have changed in a range of ways. The cost of capital has increased. Of late we have seen a significant devaluation or reduction in the value of the Australian dollar, and virtually all of the equipment for this would be sourced from overseas. The economics of building this are not getting easier.

Senator BIRMINGHAM—Since you proposed it you have seen the Australian dollar go up and down, but your point is taken.

Mr Quilty—Yes. Not only that, but we have to keep shareholders in mind and their expectations are that they will reward companies that meet their targets and that do not in any way dilute returns. They are not particularly enthusiastic about overly investing in terms of the capital. It is a more difficult environment.

Senator IAN MACDONALD—I waited patiently right until the end to ask one question and Senator Birmingham asked it. Why does Telstra need \$5.7 billion from the taxpayer?

Mr Quilty—Up to \$4.7 billion.

Senator IAN MACDONALD—I am sorry, \$4.7 billion.

Mr Quilty—We have not necessarily asked for \$4.7 billion, but the fact of the matter is that in terms of building out a network to 98 per cent it cannot be done on a purely commercial basis. The economics do not stack up without some sort of government subsidy or assistance.

Senator IAN MACDONALD—Without the \$4.7 billion, what could Telstra do? I obviously do not want you to confirm this, but there is media speculation that Telstra will be putting in at least \$10 billion of its own money on top of the almost \$5 billion of taxpayers money. I do not want you to comment on that; that is just media speculation. Obviously there is going to be a big investment from your shareholders. What couldn't you do if you did not have the \$4.7 billion?

Mr Quilty—What could we do or couldn't we do?

Senator IAN MACDONALD—Either. Really, what couldn't you do?

Mr Quilty—What couldn't we do? We certainly are not going to do anything that dilutes our shareholder returns. The reason I make that point is that what we are looking at is that there are choices for Telstra, in terms of its own shareholders, and there are choices in terms of people who invest in Telstra. If Telstra makes a choice that is seen as diluting, or does dilute, the returns that it provides to its shareholders that is simply not in the company's interest. We need to be first and foremost absolutely cognisant of that.

In terms of the build, obviously what we proposed last year was to build to the five capitals plus the Gold Coast and we proposed to do that without government funding, but we needed regulatory certainty. It was going to be an open access network, but we needed to lock in the regulatory regime throughout the life of the investment.

Senator IAN MACDONALD—You already have networks up to my neck of the woods in Townsville and Cairns and perhaps out to Mount Isa. I am just wondering if, for example, you were not successful—that is hypothetical—it was suggested to us and no doubt someone in your organisation has been avidly reading all of the *Hansard* evidence that has been given by others, and I think it was iiNet who suggested to us in Perth that really the network is already there. I think they expressed some surprise; I do not want to verbal them, but as a précis I thought they said, 'Why go through this process? It is already there, with a bit of extra regulatory arrangement.' Is that a view Telstra would share?

Mr Quilty—As I indicated at the start—

Senator IAN MACDONALD—I was not here.

Mr Quilty—I do not say that disparagingly. To go back to a point I made earlier, one of the tremendous potential positives here is that driving that fibre out close to the premises will remove those distance limitations and will get over the broadband blocker issues in the metropolitan areas as well as the regional areas. There are limitations in terms of the current network. With that said, earlier this year we committed to putting ADSL2+ into a further 900 or so exchanges, and virtually all of those were rural exchanges. As I indicated earlier, 92 per cent of the population live in areas that are enabled by ADSL and 70 per cent—

Senator LUNDY—But, as we established, less than 50 per cent can actually physically get ADSL.

Mr Quilty—Yes, that is right. That is the fundamental point. The other thing is that Telstra's Next G network is available, providing both mobile voice and wireless broadband services to 99 per cent of the population. We announced last week that we will be enabling that network and providing devices that provide speeds up to 21 megabits from next year, so there are other alternatives. Optus and Vodafone are also driving out their wireless broadband networks as well.

It is certainly not the case that the vast majority of people in Australia cannot get broadband. It is quite the opposite. The government has particular programs, as did the previous government, in terms of the small percentage of people who are not able to get broadband to provide subsidies to obviously further drive out the networks.

Senator IAN MACDONALD—I would like to clarify that the 92 per cent to the 98 per cent is what the \$4.7 billion will buy?

Mr Quilty—No, it is not. What we say with the ADSL is that 92 per cent of the population live in areas where their local telephone exchange is enabled with ADSL.

Senator IAN MACDONALD—Which you are going to do anyhow.

Mr Quilty—That exists now as we speak. In terms of that broadband solution, it is a distance limited solution, so whilst 92 per cent of Australians might live in areas where their exchange is enabled, my estimate is that only around 50 per cent can get the full speed benefits that you would get from ADSL if you lived, if you like, right next to the exchange. One of the big positives here is that we hopefully remove those distance limitations. It is not just moving from 92 per cent to 98 per cent. Those people that do not get the benefits of ADSL, or the full speed benefits, or in some cases do not get any; they can live in metropolitan Melbourne and Sydney, just as they might live somewhere in the bush.

CHAIR—We have a couple of minutes left. I have one other senator who would like to ask a question.

Senator IAN MACDONALD—Again without attempting to look at your proposal, from what you have just said you accept that the \$4.7 billion will really be to connect the bush plus those parts of Australia that are not close enough to your ADSL2+ to get a first-rate service?

Mr Quilty—It is not necessarily put that way in the RFP.

Senator IAN MACDONALD—No.

Mr Quilty—What I can say is that with the right certainty there are likely to be commercial propositions in metropolitan areas and less so in regional areas.

Senator IAN MACDONALD—This is hypothetical. I do not want to put a hypothetical to you, but if you did not succeed or did not end up putting in a bid, you have a pretty good network already that you would obviously—being in the business and with shareholders—continue to expand on without the \$4.7 billion. You might not get the 98 per cent and the fabulous quality everywhere, but you would still provide a pretty good service to most of your paying customers.

Mr Quilty—It is a somewhat hypothetical question in many ways. One of our fundamental points is that without the regulatory certainty we are not in a position to roll out fibre-to-the-node in the cities but, having said that, obviously we now provide an array of services and we think they are a pretty good array of services.

Senator IAN MACDONALD—Thank you.

CHAIR—Senator Minchin.

Senator MINCHIN—My question follows on from Senator Macdonald on this funding issue. Mr Quilty, you said that the government's objective of 98 per cent coverage with fibre-to-the-node at 12 megabits cannot be done on a purely commercial basis. That was your evidence. Among the government's other objectives is that the government will be provided with a return on its investment of up to \$4.7 billion. What you are saying is that those objectives are completely incompatible; it cannot both build a network based on the specifications of 98 per cent fibre-to-the-node with 12 megabits and get a return on what it describes in the RFP as an investment of \$4.7 billion. You are saying that is impossible. That would have to be not an investment but a straight subsidy.

Mr Quilty—What I am saying is that commercially we could not, even with regulatory certainty, roll out a fibre-to-the-node network to 98 per cent. The economics would not stack up in terms of us doing it. In terms of the government's RFP, you read it as it stated. I am not sure that I can take it any further than that. My point is that commercially, without government money, it is simply not feasible to roll out to that footprint, but that is not what the government is asking in the RFP.

Senator MINCHIN—It has said that it wants a return on its investment. It has not talked about a subsidy at all. It said it wants a return on its investment. As the Prime Minister described in the election campaign, it wants an equity partner. Just finally on that, because I appreciate you are having some difficulty answering that, your CFO said that your company would not participate in this if indeed the government was an equity partner. Does that remain the case?

Mr Quilty—That is the case.

CHAIR—Thank you, gentlemen. Thank you Telstra and thank you for your indulgence today in terms of timing. The committee will provide you with some further questions on notice.

Mr Quilty—We will look forward to that.

Committee adjourned at 8.47 pm