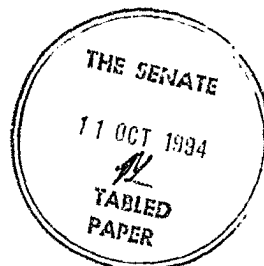


DEPARTMENT OF THE SENATE  
PAPER No. 6511  
DATE  
PRESENTED  
11 OCT 1994  
*Murray Evans*

The Parliament of the Commonwealth of Australia

Joint Committee of Public Accounts



## REPORT 333

# The Sale of Aussat

September 1994

Australian Government Publishing Service  
Canberra

PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA



Report  
333

The Sale of Aussat

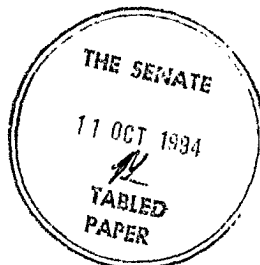
September 1994

Joint Committee of Public Accounts

DEPARTMENT OF THE SENATE  
PAPER No. 6671  
DATE  
PRESENTED  
11 OCT 1994  
*Mary Evans*

The Parliament of the Commonwealth of Australia

Joint Committee of Public Accounts



## REPORT 333

### The Sale of Aussat

September 1994

Australian Government Publishing Service  
Canberra

## MEMBERSHIP OF THE COMMITTEE

Mr L J Scott, MP (Chairman)

Mr A M Somlyay (Vice-Chairman)<sup>1</sup>  
Senator W R Parer (Vice-Chairman)<sup>2</sup>

Senator B Cooney

Mr J H Beale, MP<sup>3</sup>

Senator K J Denman<sup>4</sup>

Hon R J Brown, MP

Senator M G Forshaw<sup>5</sup>

Mrs M Easson, MP

Senator B F Gibson

Mr E J Fitzgibbon, MP

Senator B Neal<sup>6</sup>

Mr A P Griffin, MP

Senator the Hon M Reynolds<sup>7</sup>

Mr C D Haviland, MP

Senator B L Woods<sup>8</sup>

Mrs J E Moylan, MP<sup>9</sup>

Mr W L Taylor, MP

Mr M A J Vaile, MP

Secretary: Mr G Harrison

---

1. Vice-Chairman from 29 June 1994  
2. Discharged 9 June 1994  
3. Appointed 29 June 1994  
4. Discharged 17 March 1994  
5. Appointed 12 May 1994  
6. Appointed 17 March 1994  
7. Discharged 12 May 1994  
8. Appointed 9 June 1994  
9. Discharged 29 June 1994

MEMBERSHIP OF THE  
SECTIONAL COMMITTEE ON  
AUDITOR-GENERAL'S REPORTS

Mr L J Scott, MP (Chairman)

Senator Parer	Mr E J Fitzgibbon, MP
	Mr A P Griffin, MP
	Mr C D Haviland, MP
	Mrs J E Moylan, MP
	Mr A M Somlyay, MP
	Mr W L Taylor, MP
	Mr M A J Vaile, MP

Secretary: Dr J Carter

Inquiry Staff: Mr R Allen  
Miss Y Campagna

DUTIES OF THE COMMITTEE

The Joint Committee of Public Accounts is a statutory committee of the Australian Parliament, established by the *Public Accounts Committee Act 1951*.

Section 8(1) of the Act describes the Committee's duties as being to:

- examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of section 50 of the *Audit Act 1901*;
- examine the financial affairs of authorities of the Commonwealth to which this Act applies and of inter-governmental bodies to which this Act applies;
- examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- report to both Houses of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- report to both Houses of the Parliament, any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question.

The Committee is also empowered to undertake such other duties as are assigned to it by Joint Standing Orders approved by both Houses of the Parliament.

## CONTENTS

Chapter	Page
Membership of the Committee	iii
Membership of the Sectional Committee	iv
Duties of the Committee	v
List of Abbreviations	viii
Chairman's Foreword	ix
Recommendations	xi
1. INTRODUCTION	1
Background to the Review	1
The Structure of the Report	2
2. THE AUSSAT SALE IN PERSPECTIVE	3
The Establishment of Aussat	3
Aussat's Activities	4
Aussat's Financial Performance	6
Prelude to the Aussat Sale - New Policy Directions	9
The Sale of Aussat	11
Future Plans and Undertakings by Optus	13
3. <i>AUDIT REPORT NO. 33, 1992-93</i>	14
The Key findings and Recommendations	14
Additional Information within <i>Audit         Report No. 33, 1992-93</i>	15
Responses to the Audit	15
Assessment of Responses	15

4. CONSIDERATION OF THE ISSUES	16
Introduction	16
The Sale Price of Aussat	16
Network Rollout	18
<i>Monitoring Mechanisms</i>	20
<i>Excusable Events</i>	23
<i>Penalties for Non-performance</i>	25
Law Enforcement Background Inquiries	29
Competitive Impact of the Aussat Sale	30
Best Practice in the Sale of Government Assets	31

## APPENDICES

Appendix I Witnesses to the Public Hearing	33
Appendix II Submissions and Exhibits	35

## LIST OF ABBREVIATIONS

ANAO	Australian National Audit Office
Aussat	Aussat Pty Ltd - the telecommunications company sold to Optus
Austel	Australian Telecommunications Authority - the Australian telecommunications industry regulator
DCA	Department of Communications and the Arts
DoF	Department of Finance
DTC	The former Department of Transport and Communications
Optus	Optus Communications Pty Ltd
OTC	Overseas Telecommunications Corporation Ltd
STCST	Second Telecommunications Carrier Selection Team
Telecom	The trading name in Australia of Telstra Corporation Ltd
Telstra	Telstra Corporation Ltd. Formerly the Australian and Overseas Telecommunications Corporation, which was created through the merger of the former Telecom Australia and OTC
TIDA	Telecommunications Industry Development Authority

## CHAIRMAN'S FOREWORD

This Report reviews *Audit Report No. 33, 1992-93, The sale of Aussat and best practice for the sale of Commonwealth assets*, produced by the Auditor-General and tabled in Parliament on 13 May 1993.

The completion of the Aussat sale in December 1991 marked an important step in the development of Australia's telecommunications system. The sale was coupled with the granting of a general telecommunications licence to the successful bidder, Optus Communications, thus removing Telecom's longstanding monopoly in this field. The present duopoly arrangements are scheduled to terminate on 30 June 1997, when the industry will be exposed to even wider competition.

Key features of the Aussat sale arrangements were the requirement for Optus to design and build its own nation-wide telecommunications network, and in doing so to achieve specified targets for Australian industry participation and expenditure on research and development.

From the point of view of the Australian National Audit Office, an audit of the sale process afforded an opportunity to consider not only the efficiency of the process itself, but also the more general question of how best the Commonwealth can manage the sale of Government assets/business enterprises.

In carrying out its review of *Audit Report No. 33*, the Committee has adopted a forward looking approach. The Committee acknowledges that the selection team charged with disposing of Aussat and selecting the second telecommunications carrier had a difficult task. It also acknowledges the Auditor-General's principal finding that the sale was completed on time, in accordance with the Government's objectives and at an acceptable price. The Committee's review therefore focusses on aspects of the sale that affect the Commonwealth's interests in the future.

Two areas of interest stand out. One is to ensure that appropriate mechanisms are in place to monitor the future performance of obligations arising from the Aussat sale in the years leading up to the termination of the telecommunications duopoly in 1997. The second is to draw lessons from the Aussat sale experience to develop more effective procedures and controls for the benefit of future sales of Government assets and business enterprises. I believe the Committee's recommendations make a positive contribution in these areas.

On behalf of the Committee, I express our appreciation to the Australian National Audit Office, who carried out the efficiency audit, and to all witnesses who assisted the Committee's deliberations at the public hearing.

Les Scott, MP  
Chairman

## RECOMMENDATIONS

### Recommendation 1

*In the sale of all Commonwealth assets and business enterprises the Department of Finance, and other agencies involved, should ensure that:*

- (a) where there are performance covenants agreed to by the purchaser, there should be effective monitoring arrangements; and*
- (b) these arrangements be agreed between the parties, as part of the sale negotiations, and incorporated as an integral part of the contractual obligations arising from the sale. (paragraph 4.19)*

### Recommendation 2

*In the sale of all Commonwealth assets and business enterprises the Department of Finance, and other agencies involved, should try to ensure that any provisions for excusable events - where appropriate - be clearly defined so that the rights and obligations of both parties are clearly understood. (paragraph 4.25)*

### Recommendation 3

*In the sale of all Commonwealth assets and business enterprises the Department of Finance, and other agencies involved, should seek to maximise the Commonwealth's leverage and flexibility to enforce performance covenants entered into by the purchaser - and at the same time seek to minimise the need to do so - by using a combination of commercial and regulatory penalties or incentives. (paragraph 4.35)*



Recommendation 4

*The Department of Finance should develop and distribute some formal guidelines covering 'best practice' in the sale of large Commonwealth assets as an ongoing business venture. (paragraph 4.44)*

## 1

## INTRODUCTION

**Background to the Review**

1.1 Section 8(1)(ab) of the *Public Accounts Committee Act 1951* requires the Committee to examine all reports of the Auditor-General, including efficiency audit reports.

1.2 This report contains the results of the Committee's examination of one such report: *Audit Report No. 33, 1992-93, The sale of Aussat and best practice for the sale of Commonwealth assets*, which was tabled in Parliament on 13 May 1993.

1.3 The Committee resolved on 21 February 1994 to examine *Audit Report No. 33, 1992-93*, particularly in light of:

- the report's recommendation that the relevant Commonwealth department develop a plan for monitoring progress by Aussat and Optus regarding their network rollout and for ensuring that the scope for 'excusable events' is minimised; and
- the need to disseminate the Australian National Audit Office's guide to best practice in asset sales.

1.4 The Committee was briefed by the Auditor-General at a private meeting on 4 May 1994, and took evidence at a public hearing on 9 May 1994. Officers from the Australian National Audit Office (ANAO), the Department of Communications and the Arts, the Department of Finance, the Australian Telecommunications Authority, Telstra Corporation, and Optus Communications attended that hearing.<sup>1</sup> Arthur D Little International Inc (a consultancy firm involved in the sale) provided a written submission to the hearing.

### The Structure of the Report

1.5 This report proceeds with some background to the Aussat sale - covering the establishment of Aussat, its activities and financial performance, policy changes leading up to the sale of Aussat, the sale itself, and anticipated consequential developments.

1.6 Chapter 3 provides a background to *Audit Report No. 33, 1992-93*, a summary of the main findings, and responses to the audit report.

1.7 Chapter 4 discusses the issues raised by the audit report in light of evidence received in the departmental responses and at the public hearing.

<sup>1</sup> A list of witnesses can be found at Appendix I.

## THE AUSSAT SALE IN PERSPECTIVE

### The Establishment of Aussat

2.1 In October 1979, the Government announced its intention to establish an Australian national communications satellite system. In November 1981, Aussat Pty Ltd was incorporated in the Australian Capital Territory by the Commonwealth Government, with the Commonwealth as the sole beneficial shareholder. Aussat's purpose was to own and operate the national satellite system on a commercial basis.

2.2 The establishment of Aussat was presented to the Australian people in inspirational terms. The then Minister for Communications stated:

*... about 110 years ago people of vision, courage and resourcefulness in this great continent of ours completed the overland telegraph line. It ran between Adelaide and Darwin ... Today I wish to announce that the Government and private enterprise together are embarking on the final stage of another communications endeavour of the utmost importance to the Australian nation, that is the implementation of the national communication satellite system ... undoubtedly this splendid enterprise will have as profound an effect on Australian life ... as did that single strand of galvanised iron wire swinging from 40 000 poles between Darwin and Adelaide in 1872.<sup>1</sup>*

2.3 The company was started with an authorised capital of \$100 million (with subsequent issues and calls, the capital was fully paid up in July 1985). From the outset the Government intended that Aussat should operate on a fully commercial basis - paying taxes and, in time, returning dividends to its shareholders. The company's Memorandum of

<sup>1</sup> House of Representatives, *Ministerial Statement*, 6 May 1982.

Association stated that Aussat should convert, as soon as practicable, from a Commonwealth owned proprietary company to a publicly listed company in Australia, with up to 49 per cent of its issued capital owned by persons other than the Commonwealth or its agencies.

2.4 Under the *Satellite Communications Act 1984* (renamed in 1989 as the *Aussat Act 1984*) which governed Aussat's activities, the company was excluded from the provision of public switched voice and data services. The Act also permitted Telecom Australia to acquire up to a 25 per cent shareholding in Aussat. Telecom acquired a 25 per cent holding in 1985.

#### Aussat's Activities

2.5 Aussat has established a national satellite system comprising:

- a space segment, consisting of three satellites orbiting the earth above the equator; and
- an earth segment, consisting of a range of earth stations accessing the three orbiting satellites which vary in size and cost depending on their use.

2.6 Each Aussat satellite has 15 transponders, each capable of carrying one or two television pictures or up to 1 000 two-way telephone conversations. The system covers the whole of Australia, plus Papua New Guinea, New Zealand, and the south-west Pacific area. Aussat is in the process of replacing its earlier 'A series' satellites, which have reached or are reaching the end of their operational life with more powerful second generation 'B series' satellites. Aussat's earth segment comprises eight gateway earth stations in Australia, one in each capital city. The company has also established earth stations in Auckland and Wellington as part of its trans-Tasman services.

2.7 Aussat's main services provided through this network are:

- direct-to-home satellite broadcasting of the Australian Broadcasting Corporation, the Special Broadcasting Service, and commercial television services across Australia;
- a national aviation communications network operated by the Civil Aviation Authority which uses some 200 separate earth stations located at airports and airfields throughout Australia;
- the distribution, relay and assembly of public and commercial television programs, particularly the assembly and compilation of radio and television program material between capital cities and other centres; and
- non-tactical information and personnel data services for the Department of Defence.

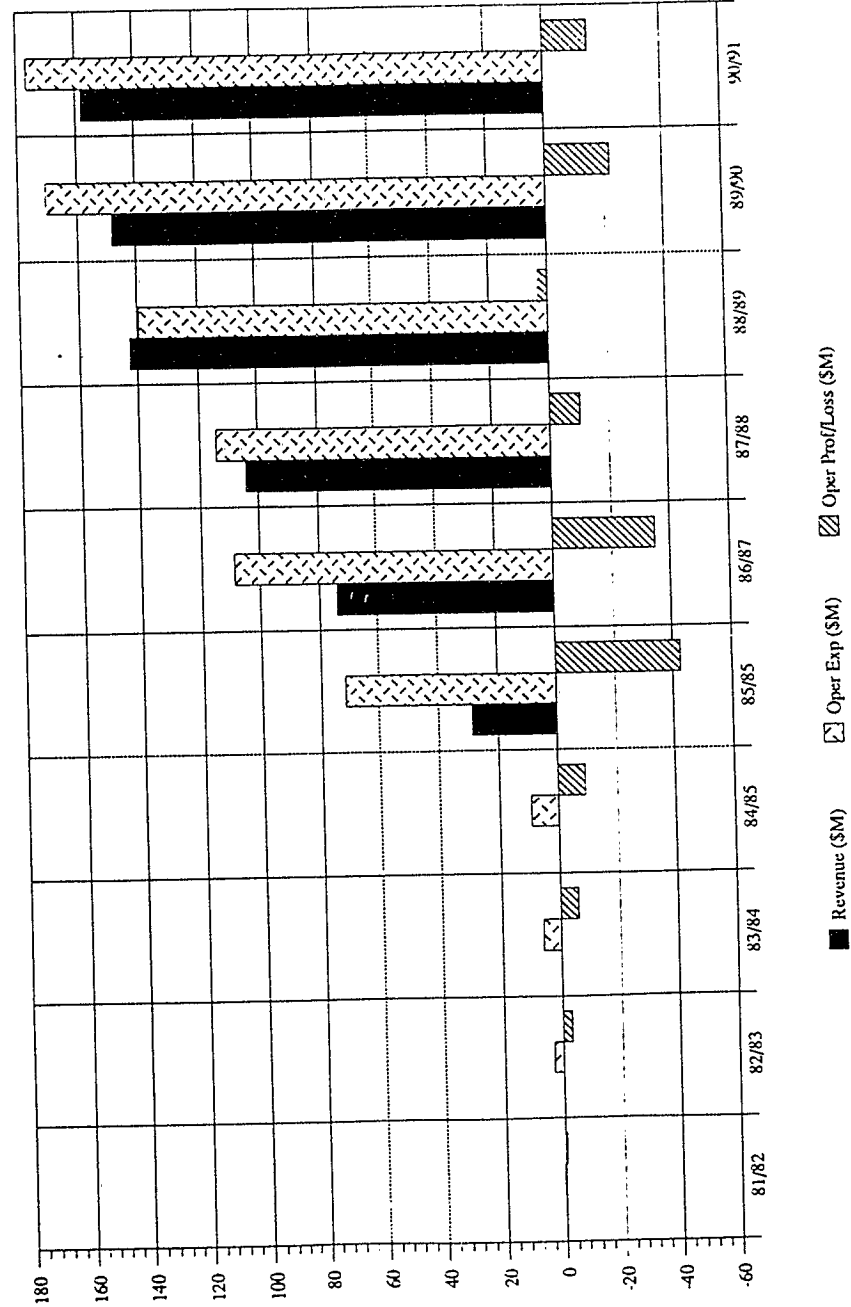
2.8 Additionally, a wide range of other organisations make use of Aussat's satellite network using their own earth stations. These include mining and exploration companies (for communication with remote sites), hotels and clubs around Australia (Sky Channel), Australian Associated Press (national news dissemination and information service), and small communities in remote areas of Australia. In total over 15 000 earth stations access the three Aussat satellites.

**Aussat's Financial Performance**

2.9 In its first four years of operation, Aussat accumulated pre-operational expenses of \$18.6 million (it received its first commercial revenue in October 1985). Over the next six years of operation, it succeeded in making a profit only once - a pre-tax profit of \$3.2 million in 1988/89.<sup>2</sup> Its operating results over the period 1981 to 1991 are illustrated in the accompanying table:

<sup>2</sup> As noted by Sam Paltridge in *A Herd of White Elephants? - Some big technology projects in Australia*, Hale and Iremonger, 1992, p. 45, even this was more contrived than real. It involved the counting as extraordinary revenue a \$20 million management fee to a Commonwealth Bank owned nominee company. The fee would ultimately be recouped by the bank.

TABLE 2.1 - Aussat Consolidated Accounts - Profit and Loss 1981/82 - 1990/91



Source: Aussat Annual Reports 1982 to 1991.

2.10 Notwithstanding a further equity injection of \$100 million in mid-1990 in the face of continued operating losses and a high gearing ratio, by the end of the 1990/91 financial year (the last full financial year before its disposal) the company had cumulative operating losses of \$136 million and residual shareholders' equity of \$64 million.<sup>3</sup> Evidence given at the public hearing indicated that by the time the sale negotiations were completed in late 1991, the shareholders' equity had fallen further to something of the order of \$48 million.<sup>4</sup>

2.11 The prognosis for the company leading up to the sale was that it:

- would need further borrowings to finance its lease of the second generation of satellites (increasing its accumulated debts to nearly \$1 billion);
- had little prospect of trading profitably under the regulatory conditions at the time; and
- would need still more injections of capital from the Commonwealth to continue trading.

2.12 Among the factors which cumulatively produced Aussat's unfavourable financial situation were:

- high start up costs in a capital-intensive industry. For example, in 1984/85 Aussat had capital works in progress of \$306 million with at that time no operating revenue;

<sup>3</sup> Australian National Audit Office, *Submission*, p. J157.

<sup>4</sup> Department of Communications and the Arts, *Transcript*, p. 22 (Canberra, 9 May 1994).

- high financing costs associated with the capital works acquisition program. For example, in 1990/91 net interest paid was \$22 million, leasing costs were \$37 million, finance charges capitalised \$7 million, and foreign currency risk management \$11 million. These costs together were roughly equivalent to two thirds of Aussat's operating revenue for the year;
- disappointing revenue growth. Although Aussat achieved strong revenue growth from 1984/85 to 1988/89, its revenue from transponder, system access and private network services - the company's key revenue sources - levelled off thereafter while costs continued to grow,<sup>5</sup> and
- ongoing restrictions on Aussat's allowable commercial activities.

#### Prelude to the Aussat Sale - New Policy Directions

2.13 In 1990, following a major telecommunications policy review, the Government announced a series of decisions designed to open the Australian telecommunications system to competition. These initiatives were taken as part of a wider policy agenda of achieving microeconomic reform in Australia. Among the major decisions were:

- Telecom and the Overseas Telecommunications Commission (OTC) to merge;
- Aussat to be sold on the basis that it would be given the right to compete with Telecom/OTC in providing a full range of telecommunication services and national and international telecommunications infrastructure (thereby instituting a telecommunications duopoly in Australia);

<sup>5</sup> In the two years following the small profit result of 1988/89, revenue increased by an average of 5.4 per cent per year, while costs correspondingly increased 12 per cent. Moreover, from the time Aussat began to earn revenue, the actual levels consistently fell below the projected levels.

- Aussat to have majority Australian ownership within five years of the sale, and Telecom/OTC to remain wholly owned by the Commonwealth;
- in considering selection of a second carrier, the Government to take into account factors such as proposals for network development, local sourcing of equipment requirements, and technology transfer;
- Telecom/OTC to be required to interconnect the new carrier to its network and provide access to ancillary services. Telecom/OTC to give the new carrier the same capacity and standard of interconnection as it provides for itself. Telecom/OTC to charge interconnection services at marginal cost;
- the sale of Aussat and the tender for the licence for the second carrier to be completed by 31 December 1991;
- given the new conflict of interest between Telecom and Aussat, Telecom to sell its 25 per cent shareholding in Aussat to the Commonwealth and to forego its positions on the Aussat board;
- the second carrier to be given a mobile phone licence earlier than or at the same time as, a third mobile phone licence is issued;
- the party acquiring Aussat to be required to provide capacity for services including pay television, remote commercial television services, and the ABC's homestead and community broadcasting satellite service; and
- the telecommunications duopoly created by these decisions to be terminated on 30 June 1997, paving the way for unlimited network competition.

### The Sale of Aussat

2.14 A special team, the Second Telecommunications Carrier Selection Team (STCST), was set up to make recommendations to the Government on the sale of Aussat and the selection of a second national telecommunications carrier. The then Department of Transport and Communications (DTC) had carriage of this project with responsibility to the then Minister for Transport and Communications and the Minister for Finance.

2.15 The STCST called for expressions of interest in December 1990. By the end of July 1991, there were two contenders for selection - the Kalori Communications Group and Optus Communications:

- the Kalori consortium consisted of the United States and New Zealand companies Bell Atlantic and Ameritech, the Hong Kong company Hutchison Whamoa, and France Telecom;
- the Optus consortium consisted of the United States company Bell South International, the British company Cable and Wireless PLC, and the Australian companies Mayne Nickless Ltd, AMP Society Ltd, National Mutual Life Association of Australasia and AIDC Telecommunications Fund.

2.16 Three of the four members of the Kalori consortium withdrew in the final stages of the tender process, severely weakening the Kalori bid. On 19 November 1991 the Government announced that Optus Communications would be the second national telecommunications carrier.

2.17 The ownership structure of Optus at that time was:

Optus Communications - 51% owned by Optus Pty Ltd  
 - 24.5% owned by Bell South  
 - 24.5% owned by Cable & Wireless

Optus Pty Ltd - 49% owned by Mayne Nickless  
 - 11.8% owned by National Mutual  
 - 19.6% owned by AMP Society  
 - 19.6% owned by AIDC.

2.18 In order to make Aussat more saleable, the Commonwealth repaid Aussat's accumulated debts of \$799 million. The price paid by Optus for Aussat was \$800 million. The payment arrangements to the Commonwealth for Aussat were for a first instalment of \$500 million to be paid immediately, with the remaining \$300 million payable in four equal six monthly instalments commencing January 1995. In the Auditor-General's assessment, the deferred payments affected the net gain to the Commonwealth. The audit report stated:

*... using [information from Optus' first annual report and] a discount rate of 11% pa,<sup>6</sup> ANAO calculated the net present value of the purchase consideration as being in the order of \$700 million.<sup>7</sup>*

<sup>6</sup> The discount rate of 11% was determined by taking the Department of Finance base rate for Commonwealth agencies of 8%, and adding a further 3% which the Department of Finance has used as a fair assessment of the additional risk for a private company.

<sup>7</sup> Auditor-General, Report No. 33, 1992-93, Efficiency Audit, The sale of Aussat and best practice for the sale of Commonwealth assets, AGPS, Canberra, 1993, p. xiii.

### Future Plans and Undertakings by Optus

2.19 As part of the sale agreement, Optus undertook to achieve certain goals over the period leading up to June 1997, when the duopoly arrangement ceases. The principal undertakings were to:

- establish its own fixed and mobile telecommunications network in Australia. Optus would provide domestic long distance and international (ISD) services for 45 per cent of the Australian population in 1992, progressively increasing to 100 per cent by 1997 (the so called 'network rollout'). Optus would also establish its cellular mobile (or wireless) network in major population centres, with coverage to approximately 80 per cent of the Australian population by 1997; and
- achieve certain levels of investment, Australian content, and research and development and training expenditure. Optus plans to spend some \$2 billion on designing and building its fixed and mobile networks. Its expenditure guidelines will ensure that the average Australian content of its total capital expenditure will be over 70 per cent. Optus and its strategic partners plan to spend \$400 million over a ten year period on research and development. It will establish an education and training program and has committed itself to spend \$100 million in the first five years of operation.

### Key Findings and Recommendations

3.1 The principal finding of *Audit Report No. 33, 1992-93* was that the sale to Optus of Aussat and the grant to Optus of licences to operate as Australia's second communications carrier were completed on time, in accordance with the Government's objectives and at an acceptable price.

3.2 While the sale was brought to a successful conclusion, ANAO made recommendations covering what it saw as the need for:

- guidelines and contractual provisions for the review of advisory consultants' performance;
- formal documentation in the assessment of bids for Government assets that identifies conformance with requirements, along with any qualifying, conditional or subsequent losses;
- an independent valuation before bids are received in the sale of Government assets;
- law enforcement background inquiries in respect of final tenderers in the sale of Government assets of national significance;
- an evaluation methodology to be formally established before public involvement is sought in the sale of Government assets; and
- a plan for monitoring progress by Aussat and Optus regarding their network rollout and industry development obligations.

### Additional Information within *Audit Report No. 33, 1992-93*

3.3 Besides giving a description of the audit and discussing its main findings and recommendations, the report contained a useful appendix entitled, *Best practice for the sale of Commonwealth assets as business ventures*.

### Responses to the Audit

3.4 The recommendations contained in the audit report were generally supported by the relevant departments. If an individual recommendation was not fully supported, there was usually support for the general principle which lay behind it. In a number of instances, departments argued for greater flexibility and discretion in applying a particular principle, citing the unique circumstances of the Aussat sale.

3.5 The one instance in which there was a disagreement of substance was over the adequacy of arrangements for monitoring Optus' performance of its network rollout obligations. DTC indicated that it had completed arrangements with Optus for periodic reporting to the Department, and that it regarded further monitoring mechanisms as unnecessary and inappropriate.

### Assessment of Responses

3.6 While departmental responses to the audit report were generally positive, the Committee had a concern over the effectiveness of the arrangements for monitoring Optus' performance.

3.7 Completion of the Optus network will represent a major milestone in the development of Australia's national telecommunications infrastructure. The Committee considered that the question of monitoring arrangements and other matters raised in *Audit Report No. 33, 1992-93* warranted further investigation.



## CONSIDERATION OF THE ISSUES

## Introduction

4.1 As indicated in Chapter 1, the Committee took evidence at a public hearing from ANAO, the Department of Communications and the Arts (DCA), the Department of Finance (DoF), Arthur D Little International Inc (written evidence only), the Australian Telecommunications Authority, Telstra Corporation, and Optus Communications. This chapter discusses the main issues arising from the hearing.

## The Sale Price of Aussat

4.2 The Committee inquired as to:

- the financial position of Aussat at the time of its disposal;
- its prospects as a going concern;
- the value of the telecommunications licence rights attached to the sale of Aussat; and
- overall, whether the Commonwealth received a reasonable price from the sale.

4.3 The financial position of Aussat at the time of its disposal was well summed up by Mr Michael Hutchinson, Deputy Secretary, DCA. He stated:

*At the time Aussat was sold ... the Commonwealth repaid approximately \$800 million of debt that was then accrued to Aussat. The books of Aussat at the time indicated there was still \$48 million of residual equity; it was not quite broke when we sold it. It is worth commenting that that is an extraordinarily high level of debt in proportion to equity*

*for a commercial venture which is essentially an up-front investment on infrastructure that is going to be completely unused on day one and for which the market has to be developed. So for the life of the asset, the capacity utilisation of the asset is going to be fairly low on average.<sup>1</sup>*

4.4 As to the commercial prospects of Aussat, Mr Hutchinson commented:

*Under the regulatory regime that existed as the Government launched the review of structural arrangements for all the carriers that eventually led to the decision to introduce competition, the commercial prognosis for Aussat was that it would be unlikely ever to trade profitably and would eventually, within a reasonable period of time, have gone out backwards. As it was, by the end of 1991, the extra \$100 million of equity that had gone in had largely gone. It was down to \$48 million altogether and the \$100 million was put in to allow it to continue trading.<sup>2</sup>*

4.5 The Aussat sale was unusual in that the transaction bundled together the disposal of an ailing satellite service with an auction for the country's second general telecommunications licence (with the resulting duopoly assured until mid-1997). It is difficult to assess the value of the two components separately. Mr Hutchinson said in evidence that at one stage Optus had given an informal indication that their \$800 million estimate comprised essentially \$100 million for the business of Aussat and \$700 million for the rest. He emphasised that this was not a formal valuation, just an indicative feel.<sup>3</sup>

<sup>1</sup> Department of Communications and the Arts, *Transcript*, p. 22 (Canberra, 9 May 1994).

<sup>2</sup> DCA, *Transcript*, pp. 34-35 (Canberra, 9 May 1994).

<sup>3</sup> DCA, *Transcript*, p. 35 (Canberra, 9 May 1994).

4.6 The immediate budgetary impact for the Commonwealth of the sale of Aussat was to increase net outlays by \$300 million. This occurred through the special appropriation expended in 1991-92 of \$800 million to repay Aussat's accumulated debts, less \$500 million paid by Optus in December 1992 as its first instalment of the \$800 million purchase price.

4.7 From the Commonwealth's perspective, the sale value of Aussat was negative. The \$800 million paid by Optus almost exactly offset the amount paid by the Commonwealth to repay Aussat's accumulated debts. However, according to ANAO the effect of payment by instalments by Optus was to reduce the net present value of the purchase - to \$700 million.<sup>4</sup> In addition, as indicated above, the equity of \$200 million injected into Aussat over the life of the company was lost.

4.8 The Committee noted the difficulties in arriving at a valuation of Aussat - especially given the bundling together of the sale of an asset and the sale of a licence - and noted the advice given that the sale price had been within the acceptable range advised by SCST's principal consultants, CS First Boston Australia. Accordingly, the Committee agrees with the Auditor-General's finding that Aussat was sold at an acceptable price.

#### Network Rollout

4.9 One of the principal concerns of the Committee was to explore further the issues raised in *Audit Report No. 33, 1992-93* regarding Optus' network rollout obligations and the mechanisms in place to ensure these obligations are fulfilled.

<sup>4</sup> Auditor-General, *Audit Report, No. 33, 1992-93*, p. xiii. The basis for this assessment can be found at paragraph 2.18.

4.10 These matters were raised in the Auditor-General's opening statement to the Committee. He said:

*... why are we concerned about monitoring Optus' progress? We are concerned that there is a risk that without effective monitoring of Optus' progress in establishing its communications network, the social and economic benefits expected by the government from the introduction of competition in the industry may not be realised ... With regard to the risk of timetable not being met, we note that if Optus fails to remedy a breach, the only sanction available to the Commonwealth within the terms of the [development] deed is to license another carrier; that is, to terminate the duopoly. In our opinion, this sanction will have a lessening impact in the final years of the agreement, that is, from 1995 onwards, such that Optus may be able to avoid full achievement of its commitments without penalty. Thus, the public may never receive the full complement of benefits promised during the sale negotiations.<sup>5</sup>*

4.11 The Committee sought details of Optus' performance to date in meeting its network rollout obligations. Austel's representative, Dr Robert Horton, advised the Committee:

*Optus has undertaken and has provided reports to Austel immediately following the end of each calendar year on its roll-out activities and we have been able to certify that Optus has indeed achieved those targets. In the last report we had - in fact Optus was pleased to inform us and I am pleased to convey to you - not only did they meet the 1993 target, but they also met the 1994 and 1995 targets. Hopefully that will give some further degree of comfort to the ANAO in their observations of the monitoring which was felt would be required of Optus.<sup>6</sup>*

<sup>5</sup> Auditor-General, *Transcript*, p. 7 (Canberra, 9 May 1994).

<sup>6</sup> Austel, *Transcript*, p. 49 (Canberra, 9 May 1994).

4.12 The same theme was echoed by the principal Optus representative, Mr Ross Ramsay. Mr Ramsay said:

*The key thing about the process [that is the establishment of Optus] is that a company has been created which has exceeded every obligation it has undertaken to the Commonwealth. It has asked for no excusable events. It has spent money faster than it planned and it has provided considerable competition into the Australian market generally ... It is impossible to build Rome in a day. We are building the network as fast as we can and I assure members that we will roll out to the full extent of the obligations.<sup>7</sup>*

#### *Monitoring Mechanisms*

4.13 The heart of the Auditor-General's concern about network rollout was that without effective monitoring arrangements, realisation of the expected benefits of competition could not be assured. On this, Mr Hutchinson of DCA said:

*The audit office recommended that a plan be developed for monitoring progress by Optus regarding network rollout. In view of that recommendation, the department consulted Optus. We have now exchanged formal letters with Optus detailing specific six-monthly reporting requirements, including details of Optus' progress towards meeting its network obligations and whether roll-out is progressing satisfactorily. Two such reports have already been received and they indicate that Optus' actual network roll-out is far ahead of its obligations.<sup>8</sup>*

4.14 Mr Hutchinson provided copies to the Committee, on a commercial-in-confidence basis, of the exchange of letters (comprising a letter from DCA to Optus of 7 September 1993 and from Optus to DCA of 1 October 1993). In addition, the Committee also received copies of the first two reports under the monitoring arrangements.

<sup>7</sup> Optus, *Transcript*, p. 50 (Canberra, 9 May 1994).

<sup>8</sup> DCA, *Transcript*, p. 24 (Canberra, 9 May 1994).

4.15 The Department of Industry, Technology and Regional Development submitted to the Committee details of its monitoring arrangements with Optus in regard to Optus' industry development undertakings. The main elements of these arrangements are:

- progress is monitored by the Telecommunications Industry Development Authority (TIDA), a non-statutory authority established by the Government in 1992 for that purpose (TIDA similarly monitors the industry development plans of Telecom and Vodafone). TIDA is comprised of six persons from the private sector with relevant expertise;
- Optus reports annually to the Minister on its industry development performance against commitments, and the Minister refers these reports to TIDA for evaluation and advice;
- TIDA makes a detailed assessment of Optus' reports, consulting with Optus in the process. The process involves detailed formal reporting and presentation by Optus, and follow up by the TIDA secretariat of any issues identified by TIDA as needing further information or clarification. TIDA then reports its findings to the Minister;
- the Minister consults with the Minister for Communications and the Arts. The Government's views on industry development performance are then made known to Optus; and

- an independent review of achievements relating to local content, research and development and training is carried out by the Department's internal auditor on TIDA's behalf.<sup>9</sup>

4.16 The Committee acknowledges that Optus was not required by the original sale agreement to provide progress reports on the achievement of its network rollout obligations.<sup>10</sup> The Committee agrees with the Auditor-General that DCA 'should develop a plan to monitor the performance of Optus'<sup>11</sup>, especially given that Optus' performance obligations extend for over five years from the time of the contract.

4.17 The Committee is satisfied that the arrangements now in place constitute a suitable monitoring mechanism.

4.18 However, the Committee notes that the monitoring arrangements were established almost a year after the contract of sale, and, apparently, in response to the audit report. The Committee believes that where the purchaser of a Commonwealth asset agrees to meet certain commitments following the sale, appropriate monitoring arrangements should be incorporated into the contract for the sale rather than being negotiated after the event.

<sup>9</sup> Department of Industry, Technology and Regional Development, *Submission*, pp. S3957-3958.

<sup>10</sup> Auditor-General, *Audit Report No. 33, 1992-93*, p. 8.

<sup>11</sup> Auditor-General, *Audit Report No. 33, 1992-93*, p. 10.

#### 4.19 Recommendation 1

*In the sale of all Commonwealth assets and business enterprises the Department of Finance, and other agencies involved, should ensure that:*

- where there are performance covenants agreed to by the purchaser, there should be effective monitoring arrangements; and*
- these arrangements be agreed between the parties, as part of the sale negotiations, and incorporated as an integral part of the contractual obligations arising from the sale.*

#### *Excusable Events*

4.20 The Committee explored ANAO's concern that the provision for 'excusable events' in the sale contract could threaten the timing of the network rollout obligations. This concern derives from;

- the vague, broad definition of excusable events in the contract (more open ended than the usual *force majeure* provisions of commercial contracts);
- the potential for Optus to invoke these provisions to seek delay in rolling out the network (a request which the Commonwealth could not unreasonably deny); and
- the limited and inflexible range of responses the Commonwealth could use in the face of rollout delays.

4.21 It was apparent from evidence given at the hearing that the excusable events question had been a sticking point in the negotiations between STCST and Optus. According to Mr Hutchinson's evidence:

*In the case of the Aussat sale, all excusable events clauses in the network roll-out deed were the subject of intense negotiation over an extended period of time. Optus required the inclusion of such clauses for the sale to proceed. It was a deal breaker; without such clauses, Optus would not have signed up. The clauses in no way give Optus carte blanche. Optus is only released from an undertaking to the extent that an excusable event limits or impacts on that undertaking.<sup>12</sup>*

4.22 The Committee acknowledges that the contract negotiations took place in the context of a limited field of applicants and a rapidly approaching deadline imposed by the Government for completion of the sale. These factors restricted the negotiating leverage of STCST. It was almost inevitable that some aspects of the negotiated sale contract would be less than ideal. This appears to have been the case with the question of excusable events. To quote Mr Hutchinson again:

*The excusable events that were included in the deed were the best achievable in commercial negotiation under the circumstances.<sup>13</sup>*

4.23 The Committee was informed by Optus at the hearing that there have been no excusable events to date. The Committee was also advised by DCA that Optus has agreed to give DCA forewarning of any intention to invoke the excusable events provisions.

4.24 The Committee accepts that the excusable events provisions in the contract for the sale of Aussat were the best outcome possible in the circumstances. Nevertheless, the Committee is concerned that the provisions are worded vaguely and broadly, and that it is unclear precisely what circumstances would fall within the scope of the provisions.

<sup>12</sup> DCA, *Transcript*, p. 25 (Canberra, 9 May 1994).

<sup>13</sup> DCA, *Transcript*, pp. 25-26 (Canberra, 9 May 1994).

#### 4.25 Recommendation 2

*In the sale of all Commonwealth assets and business enterprises the Department of Finance, and other agencies involved, should try to ensure that any provisions for excusable events - where appropriate - be clearly defined so that the rights and obligations of both parties are clearly understood.*

#### *Penalties for Non-performance*

4.26 As indicated above (paragraph 4.10), the Auditor-General was concerned about the limited range of measures which the Commonwealth had to remedy any breaches of rollout obligations, and the diminishing value of those sanctions in the final years of the duopoly period. This view was echoed by Arthur D Little International Inc., consultants to STCST. In a written submission presented to the hearing the consultants said:

*Any licence is only as useful as its capacity for enforcement. Termination of the duopoly (ie. revocation of the licence) is an 'all or nothing' sanction, capable of causing greater loss to Australia than to Optus if invoked for any reason other than sustained and severe non-compliance with licence conditions. The non-complying licence holder knows this and so might regard a threat of licence revocation for any lesser reason simply as a bluff.*

*It is far better to have a mechanism for securing compliance before a problem gets out of hand and a penalty that might be invoked at any significant instance of non-compliance. The only penalty that provides a deterrent without distorting the basis of competition between the businesses is a pecuniary one. For this reason, Arthur D Little recommended that the carrier licences should provide for pecuniary penalty for avoidable and/or repeated under-performance.<sup>14</sup>*

<sup>14</sup> Arthur D Little International Inc., *Submission*, p. S3961.

4.27 Evidence from DCA indicated that a liquidated damages approach as recommended by Arthur D Little was unacceptable to the bidders for Aussat. Mr Hutchinson said:

*... it was a case of [a liquidated damages approach] not being possible with either Optus or indeed with the other consortium as we went through these negotiations. It was a deal breaker and they were not going to accept that.<sup>15</sup>*

4.28 The question remains whether, in light of the Auditor-General's and Arthur D Little's comments, the Commonwealth's interests are protected by way of an effective penalties regime for non-performance.

4.29 The argument put forward by DCA at the hearing is to the effect that:

- the whole package of arrangements under which Optus operates contains various provisions for pecuniary penalties for non-performance (in effect, a liquidated damages approach by other mechanisms); and
- the same package of arrangements contains strong commercial incentives for Optus to fulfil its obligations.

4.30 These mechanisms were outlined to the Committee at the hearing by Mr Hutchinson of DCA:

*The first mechanism is that the key milestones in its [Optus'] network roll-out plan are included as a licence condition. Austel monitors compliance with the licence condition. In the event that Optus fails to meet a licence condition, Austel can then issue an order to comply and a breach of that order can yield a \$10 million fine in the Federal Court. It is the formal regulatory provision.*

<sup>15</sup> DCA, *Transcript*, p. 39 (Canberra, 9 May 1994).

*The second mechanism is that the network roll-out deed has Optus explicitly acknowledging that its failure to meet its obligations in that deed will yield the Commonwealth pecuniary and non-pecuniary penalties. That sets the framework for action for damages. That was the outcome of an extended negotiation about whether in fact we write in specific liquidated damages into the contract. My negotiators tell me that there is a lot of blood on the carpet, but that they got in an explicit acknowledgment of pecuniary penalties.*

*However, the most ... [severe] pecuniary penalty that attracts to Optus, in the event that it fails to roll its network out, arises in its relationship with Telecom. Optus has an agreement with Telecom which sets out the terms and conditions upon which Optus uses Telecom's network. The introductory interconnect charges, which were established by regulation, apply only until such time as certain triggers are reached.*

*In the event that Optus misses a network roll-out date then it loses access to those favourable interconnect rates. Since the interconnect rates are so many fractions of a cent or so many cents per minute of traffic, and Optus is carrying very substantial amounts of traffic, it would not want to jeopardise those things. The most important pecuniary penalty, consistent with the commercial and competitive framework that has been put in place, is a commercial one and not a regulatory one.<sup>16</sup>*

<sup>16</sup> DCA, *Transcript*, pp. 38-39 (Canberra, 9 May 1994).

4.31 In addition to the negative incentives of commercial and regulatory penalties, Optus also has the positive incentive of the market opportunity provided by its general telecommunications licence. As Mr Costanzo of Optus put it:

*... the network development deed has some commercial imperatives. If Optus does not roll out its network, it is not a commercially viable business. There is a very narrow window of opportunity to establish a network before the duopoly expires.<sup>17</sup>*

4.32 The Committee acknowledges the negotiating difficulties which STCST experienced in including a liquidated damages approach to non-performance by Optus, as proposed by Arthur D Little. The Committee also notes the existence of a range of commercial penalties and incentives - as distinct from regulatory penalties - which provide inducements for Optus to complete its network rollout program.

4.33 The Committee considers that there is a great deal of merit in combining regulatory and commercial penalties/incentives to ensure the establishment of a second telecommunications network infrastructure. In the early years of the duopoly, when Optus is seeking to build rapidly a network and client base from scratch, the existence of either regulatory or commercial penalties seems superfluous, particularly in the higher density markets in south-eastern Australia. In that regard its quicker than required rollout to date is understandable.

4.34 As the network rolls out to areas which are more and more marginal, and as the end of the duopoly period approaches, the commercial imperatives could change. There could well become a higher commercial priority for Optus to consolidate and expand its market position in established areas and/or to offer new products or services in those areas, than to roll out its network to its extremities. This is not to suggest that Optus - which has more than met all of its obligations to date - would

<sup>17</sup> Optus, *Transcript*, p. 51 (Canberra, 9 May 1994).

forsake its obligations. But it is to suggest that the 'reserve power' of regulatory penalties could become a more important consideration to the Commonwealth in the future than it is at present.

#### 4.35 Recommendation 3

*In the sale of all Commonwealth assets and business enterprises the Department of Finance, and other agencies involved, should seek to maximise the Commonwealth's leverage and flexibility to enforce performance covenants entered into by the purchaser - and at the same time seek to minimise the need to do so - by using a combination of commercial and regulatory penalties or incentives.*

#### Law Enforcement Background Inquiries

4.36 One of the recommendations of *Audit Report No. 33, 1992-93* was that law enforcement background inquiries be made on all short listed tenderers in the sale of Government assets of national significance.

4.37 The Committee was advised that the question of law enforcement and security inquiries had been canvassed during the sale process. In the end, the selection team made a judgement that it was not a cost-effective use of resources to undertake such inquiries. As Mr Hutchinson of DCA put it:

*All the indications we had from both sides were that the companies were highly reputable and highly regulated in their home markets. They were subject to all sorts of regulatory scrutiny and there was no suspicion of any impropriety. This was not a casino licence. This was a very different exercise.<sup>18</sup>*

<sup>18</sup> DCA, *Transcript*, p. 36 (Canberra, 9 May 1994).

4.38 The view presented by DoF to the Committee was that these background checks are matters to be determined on a case-by-case basis, and a question of weighing up the costs and time delays against other considerations. The Committee supports this approach and is unconcerned by the absence of such checks in this case.

#### Competitive Impact of the Aussat Sale

4.39 During the hearing, the Committee received evidence of the public benefit deriving from the injection of competition into the Australian telecommunications industry. Mr Hutchinson of DCA referred to a recent statement by the Minister for Communications and the Arts, the Hon Michael Lee, MP, that the benefits to customers within only one year of competition have exceeded \$300 million. Other benefits of competition, less easily quantifiable in money terms, include productivity and efficiency gains and improved responsiveness to customers. Mr Hutchinson added:

*As part of the competitive regime, Telecom is subject to a price cap that forces its prices down in real terms. Because of competition, everyone's telecommunications prices are lower than they otherwise would have been. Some are benefiting more than others; there is no doubt. But the benefits are much wider than for those who are served by Optus. Those who remain served by Telecom are also benefiting and the Commonwealth is benefiting by the fact that Telstra is currently trading ... as a cash positive operation returning significant after-tax profits and significant dividends to the Commonwealth, well up on where it was before competition intruded.<sup>19</sup>*

4.40 The Committee considers that these benefits, which are only the start of the potential benefits to the nation through an improved telecommunications system, demonstrate the importance of the process of microeconomic reform which has been underway in Australia for some time.

<sup>19</sup> DCA, *Transcript*, pp. 33-34 (Canberra, 9 May 1994).

#### Best Practice in the Sale of Government Assets

4.41 One of the recommendations of *Audit Report No. 33, 1992-93* was that the 'best practice' guidelines included as an appendix to the report provide the broad guidelines for the future sale of Commonwealth assets. The guidelines were produced in the absence of formal guidelines for the sale of large Commonwealth assets as an ongoing business venture (such as Aussat).

4.42 The Department of Finance, which is responsible, amongst other things, for the management and oversight of the Government's asset sales program, indicated its support for the recommendation. At the hearing, the principal DoF representative, Dr Louise Morauta, stated that:

*... these guidelines substantially reflect the actual practice of the Department in asset sales and are being used as a general guide in current sales by the Department.<sup>20</sup>*

Dr Morauta also indicated that the Auditor-General's reports are included in the Commonwealth Manager's Toolbox, an electronic database available to all Commonwealth departments.

4.43 The Department gave the Committee no indication that it plans to develop and publish formal guidelines for the sale of assets. It seems to the Committee that such guidelines would be useful not only to DoF, but also to other agencies involved from time to time in asset sales. In formulating its final recommendation, the Committee recognises that the details of each sale need to be dealt with on a case by case basis.

<sup>20</sup> DOF, *Transcript*, p. 27 (Canberra, 9 May 1994).



4.44 Recommendation 4

*The Department of Finance should develop and distribute some formal guidelines covering 'best practice' in the sale of large Commonwealth assets as an ongoing business venture.*



Les Scott, MP  
Chairman  
21 September 1994

APPENDIX I - WITNESSES TO THE  
PUBLIC HEARING

Canberra, Monday 9 May 1994

*Australian National Audit Office*

John C Taylor, AO, Auditor-General

Warren J Cochrane, Acting National Business Director

Peter F White, Acting Group Director

David N Smith, Senior Director, Performance Audits

*Department of Communications and the Arts*

Michael J Hutchinson, Deputy Secretary (Communications)

David J Yarra, Director, Enterprise Policy Section

*Department of Finance*

Dr Louise H Morauta, Acting First Assistant Secretary,  
Transport and Government Division

Dr Greg Feeney, Deputy Chairman, Task Force on Assets  
Sales A

Mr Kym M Bills, Deputy Chairman, Task Force on Assets  
Sales B

*Australian Telecommunications Authority*

Dr Robert Horton, Member, Austel Board

*Telstra Corporation*

John A Lockwood, Director of 'Breakthrough'

Graeme B Ward, Strategy Directorate

*Optus Communications*

Paddy Costanzo, Manager, Industry Development

Ross Ramsay, Manager, Government Liaison



## APPENDIX II - SUBMISSIONS AND EXHIBITS

### Submissions

- 127 Department of Finance
- 129 Department of Transport and Communications
- 174 Department of Industry, Technology and Regional Development
- 175 Arthur D Little International Inc.
- 176 Department of Communications and the Arts - supplementary submission
- 177 Arthur D Little International Inc. - supplementary submission
- 178 Department of Communications and the Arts - supplementary submission
- A/12 Australian National Audit Office

### Exhibits

A number of confidential exhibits were submitted to the Committee.