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Rio's \$5bn raising takes gloss off Chinalco deal. Plus: Qantas dividend in doubt. From page 17



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THE AUSTRALIAN FINANCIAL REVIEW

THURSDAY 16 APRIL 2009

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■ Bill goes back to Senate ■ \$1.6bn revenue at stake ■ Election pressure on Turnbull, Fielding

Alcopops tax shapes as poll trigger

Louise Dodson, John Breusch and Marsha Jacobs

The Rudd government will resurrect its alcopops tax in a bid to shore up vital budget revenue and intensify pressure on the federal opposition to support its agenda or face a double-dissolution election.

Amid intense discussions by cabinet committees as he shapes the

BUDGET COUNTDOWN

'Nicola Roxon has failed to allay fears in the diagnostic imaging and pathology industries over budget funding cuts.' Nabila Ahmed, page 6

→ ACCC's RuddBank fears, page 3
→ Vic tax cuts ruled out, page 4
→ Emissions trading row, page 5
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most difficult budget in decades, Treasurer Wayne Swan signalled the government would move to protect an estimated \$1.6 billion in revenue

over four years to be raised by the alcopops tax.

Mr Swan said the government would reintroduce the tax to the

Senate, which if opposed in the last week in June would provide a trigger Labor could use to call a double-dissolution election.

Behind the scenes, the government has been considering options for ensuring key legislation is passed and has decided to toughen its stance against Opposition Leader Malcolm Turnbull's position of opposing much of its agenda.

Although Labor is not planning an election specifically over the alcopops measure, it has not ruled out a double dissolution and is preparing the ground for a showdown with the opposition.

The alcopops bill, which lifts tax by 70 per cent on the alcoholic drinks popular with teenagers, is the first potential poll trigger.

Continued page 6

Murray calls time on Telstra chairman

The Future Fund chief has made his unhappiness with Donald McGauchie's strategy clear, writes Pamela Williams.

The Melbourne headquarters of the Future Fund sits in a skyscraper at the Paris end of Collins Street, juxtaposed against the turrets of a neo-Gothic church.

On March 30, Donald McGauchie, the chairman of Telstra and a man accustomed to throwing his weight around, arrived for a meeting. By the time he left, McGauchie had plenty on his mind.

The meeting was led by David Murray, chairman of the Future Fund, Telstra's biggest shareholder. The fund was not happy with the telco's aggressive stance, and Mur-

ray told McGauchie it was time to end the combat and engage constructively with both the federal government and the regulator.

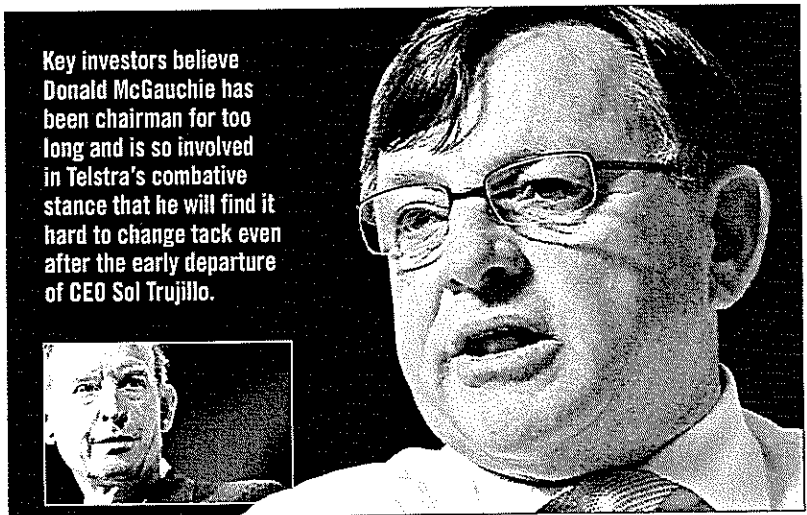
As if that was not enough, McGauchie was told that the government's forthcoming broadband proposals could provide a great opportunity for Telstra, and the Future Fund wanted to see the company proactively involved in the new network.

Murray was also expected to raise privately with McGauchie his position as Telstra chairman in the wake of the carrier's exclusion from the broadband tender after it submitted a non-conforming bid.

To Telstra Kremlinologists, that had been just one more round in the big telco's game of whack the government. But for powerful shareholders it was a step too far.

Continued page 61

Key investors believe Donald McGauchie has been chairman for too long and is so involved in Telstra's combative stance that he will find it hard to change tack even after the early departure of CEO Sol Trujillo.



Telstra chairman Donald McGauchie, right, has come under fire from Future Fund chief David Murray, inset. Main photo: PETER BRANG

What the BrisCon man really wanted

Angus Grigg and Jacqueline Maley

Entrepreneur Nicholas Bolton allegedly sought \$10 million from Leighton Holdings to forfeit his voting rights and prevent the winding up of BrisConnections, but the deal that eventually delivered him \$4.5 million could yet jeopardise Australia's biggest infrastructure project.

Questions have been raised over

Leighton's agreement to pay Mr Bolton's fee into a different company from the one that is liable for the \$155 million owed on his BrisConnections instalment units.

At issue is Leighton allowing him to siphon away his payment when the construction giant is also a 50 per cent owner of the BrisConnections management company and the builder of the \$4.9 billion Brisbane toll road.

The management company has an obligation to seek payment from unit holders who default on the \$1 per share instalment due on April 29 before calling on the underwriters, Macquarie Group and Deutsche Bank, to cover the shortfall.

This comes as the Australian Securities and Investments Commission and

Continued page 20

One surprise too far, page 20

Gwalia board's \$53m hit

James Eyers

Former directors of Sons of Gwalia have settled the damages claim brought by the failed goldminer's administrator for \$53 million, one of the largest publicly known payouts under a directors and officers insurance contract.

The landmark settlement provides the administrator, Ferrier Hodgson, with funds to pursue Sons of Gwalia auditor Ernst & Young for more than \$1.3 billion in an action that is scheduled to go to trial next year.

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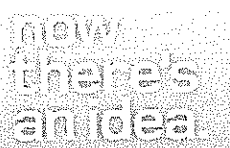
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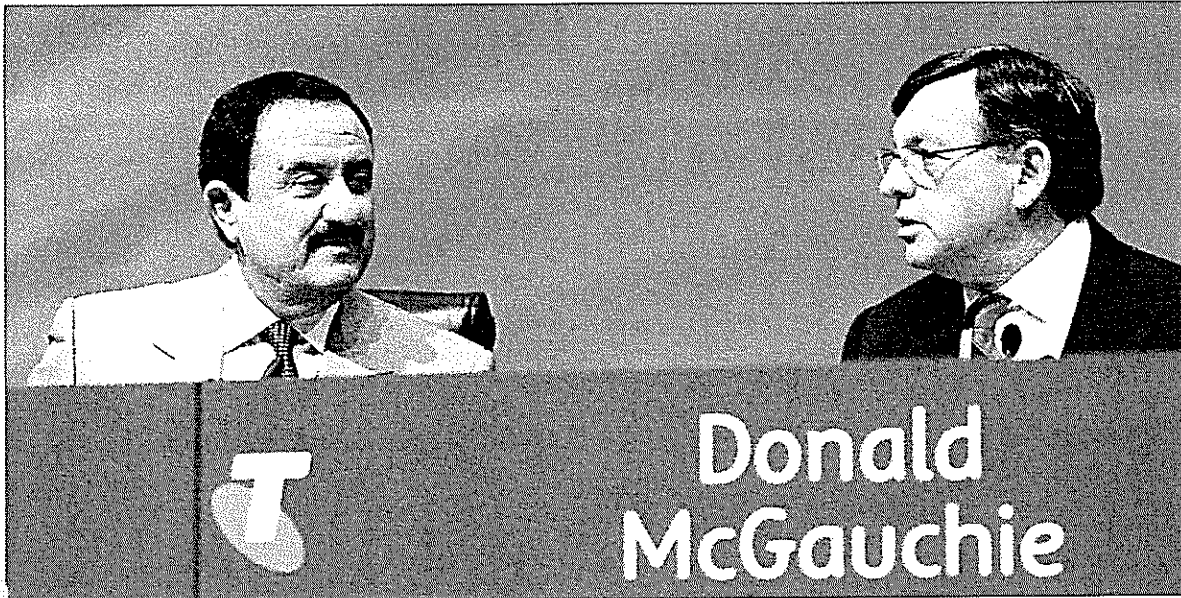


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Telstra's outgoing chief executive Sol Trujillo, left, and chairman Donald McGauchie.
Photo: JAMES DAVIES

Murray calls time on chairman

From page 1

McGauchie yesterday denied there had been any discussion of his own job during the March 30 meeting. However, he conceded that he and Murray had discussed succession planning "across the board" on a previous occasion. He told *The Australian Financial Review* he and the Telstra board respected feedback from all shareholders. "The matter of who will fulfil the role of the chairman is a matter for the Telstra board," McGauchie said.

The Future Fund is understood to have requested a meeting with the full Telstra board, which McGauchie is believed to have declined. The Future Fund was expected instead to write to individual Telstra directors to express its view on the company's strategy and future. McGauchie yesterday denied he had resisted a meeting between the Future Fund and his board. "Not true," he said. "It is also worth noting that Telstra is very conscious of its obligations and responsibility to treat all shareholders equally."

McGauchie was accompanied to the meeting at the Future Fund offices by only Telstra's company secretary. But he said yesterday that he and various directors had conducted multiple meetings with the fund since the fund took over custodial duties for the federal government's Telstra shareholding.

On the question of whether the Future Fund had advised him it would write to all Telstra directors, McGauchie said: "What the Future Fund does is a matter for the Future Fund."

It is clear that the tensions between Telstra and the Future Fund have ratcheted up. While shareholders allowed the war between Telstra and the government to run unhindered for years, the broadband outcome has focused minds. The Future Fund has 16 per cent of Telstra and seen it lose about 25 per cent of its value since a recalcitrant Telstra was evicted from the national broadband tender.

Key investors believe McGauchie has been chairman for too long and is so intimately involved in the company's combative stance that he will find it hard to change tack even after the early departure on June 30 of his personally selected chief executive, Sol Trujillo.

The Future Fund believed the American had achieved some positive outcomes at Telstra, but the stock is trading at an alarming discount, measured from the day of Trujillo's appointment to the present, even allowing for the impact of the global financial crisis. It is substandard at best, given the company's market strength.

One close observer told the *AFR* this week that some of Telstra's biggest investors had been long concerned about the hostility generated by Telstra towards the federal

government. With Trujillo now out the door, they believe McGauchie should follow.

"Don's been there too long, and there is pressure on that board now for him to go," said one insider in a position to understand the internal dynamics of the Telstra boardroom. McGauchie has been on the board since 1998 and chairman since 2004.

During the Future Fund meeting with McGauchie, he was also asked to consider hiring a local CEO after the experience of the antagonistic Trujillo, who had been arguing to the Telstra board that his replacement should come from overseas.

McGauchie and David Murray have their own history, book-ended by Telstra power-politics. After McGauchie became chairman of Telstra in 2004, there was considerable pressure from a key faction on the Telstra board to recruit Murray — the former chief executive of the Commonwealth Bank — as Telstra's next chief executive. But McGauchie wanted his own man and he hired the hard-charging Trujillo instead.

Murray, of course, went on to become chairman of the Future Fund, and as such he became McGauchie's biggest, and most powerful, shareholder.

Whatever he says, McGauchie seems to have got the message about being nicer. A top-level Telstra committee was swiftly established to negotiate the national broadband network with the government. Trujillo was pointedly sidelined from this committee. He was, in any case, constantly out of the country. The federal government had already begun to hear whispers that there had been tensions on the Telstra board about Trujillo's tenure and over his rough-house conduct with the government. The word had filtered out that Telstra had started talking to replacement candidates for CEO as far back as October last year.

Behind the scenes, Telstra started making conciliatory noises to Canberra almost immediately. And McGauchie would soon have an opportunity to publicly show his new softer tone.

But first, there was another meeting where the Telstra chairman would discover the world had changed. The board of the Reserve Bank of Australia had the good fortune to meet on a classic warm day in Brisbane last week. But for one RBA director, McGauchie, it may as well have been "storms ahead".

Before the RBA board sat down on the Tuesday to discuss interest rates, McGauchie and another RBA director, Treasury secretary Ken Henry, sat down to discuss broadband. Henry, a member of the government's taskforce on the national broadband network strategy, gave McGauchie a briefing on the details the government would release to the public 15 minutes later at 8.30 am. It was a

courtesy briefing, as Telstra, of course, was not in the running; it had been ejected from the bidding process.

What McGauchie heard from Henry was guaranteed to turn his insides to water. In that 10-minute chat, McGauchie's years of high-handed aggression and unseemly political head-butting came to an end. He had lost.

Trujillo had lost, too. His strategy had delivered Telstra the worst fate it could possibly have anticipated. One way or another, structural separation lay ahead. A staff statement issued under Trujillo's name publicly revealed the make-up of the new Telstra negotiating committee — sans the CEO even though he was not leaving for another three months.

When Trujillo announced he was leaving Telstra, Prime Minister Kevin Rudd was confronted by TV cameras. "Adios," he said with a wide smile, then laughed. It was an uncharacteristic moment for the highly scripted PM, but it should have sent a message to the Telstra board. Finance Minister Lindsay

McGauchie conceded he and Murray had discussed succession planning.

Tanner himself said a few weeks ago that the time for belligerence in the trenches was over.

Telstra has been comprehensively outfoxed by Rudd and his Communications Minister, Stephen Conroy. The government has locked up Telstra's options on every key issue — regulatory powers, spectrum, content and the hybrid fibre coaxial cable. The company is now facing functional separation, a split of its retail and wholesale arms — something it has fought against vehemently for years. But Telstra has to come to the table — or risk the wrath of its major shareholders.

One observer this week described the McGauchie/Trujillo strategy as being like two men at the helm of a ship armed with a chart showing troubled waters — and saying: "Let's sail straight in there."

After the warnings from the Future Fund, McGauchie was forced to be polite. "We look forward to having constructive discussions with the government at the earliest opportunity," he said. "There is a lot to absorb in the government's announcement and we will consider every aspect in detail."

To the legions of shareholders and the many arms of government and regulatory bodies, these words must have sounded as though McGauchie had swallowed something strange. Where was the old combat counter-attack the nation was used to? Where were the insults and the Telstra hubris? McGauchie sounded

like a normal, responsible chairman from a normal company. He sounded neutered.

By this week, Telstra was even offering to voluntarily consider separation — not that it had much choice. But the positive attitude was precisely what the doctor ordered, so to speak.

Asked yesterday by the *AFR* whether his more conciliatory tone was a product of his meeting with the Future Fund, McGauchie sidestepped. He said Telstra had long believed the outcome of the NBN process would require it to assess the best path forward. "Telstra has an appropriate dialogue with its shareholders, and the Future Fund is one of them," he said.

The day after the government's NBN announcement, McGauchie and Telstra's chief financial officer, John Stanhope, flew to Canberra for a meeting that had been arranged weeks earlier with Rudd's chief of staff, Alister Jordan. There was a cup of coffee but no biscuits. Stanhope has been trying to build momentum to take over from Trujillo and McGauchie shepherding him to Canberra seemed to be an attempt to make friends and build stocks. Certainly it also signalled "Trujillo doesn't live here anymore".

Telstra can, of course, buy in to the new fibre network. But the catch-22 is embedded in the government plans. If Telstra tips in its fibre network, its slice of the new broadband company will be capped. The government has not identified the cap but has indicated it would be no more than 20 per cent. Thus, Telstra would instantly lose control of the network and face de facto structural separation.

If Telstra decides to go its own way and refuses to tip its network in, then the government will build its own and Telstra will face a brutal regime of regulatory changes as well as having the new network built around it.

On the flanks of the government, the regulator has been watching the proceedings with great interest and playing a role in disseminating some critical issues for the taskforce. Several weeks ago, Conroy told the Australian Competition and Consumer Commission chairman, Graeme Samuel, that he would be "pleasantly shocked" when the broadband proposal was finally announced. Samuel and the ACCC, who have single-handedly held the line against Telstra's crushing market power for years, were understood to be elated by the decision last week. Samuel would only say yesterday: "We were pleasantly gobsmacked."

McGauchie has a long history with the Labor Party, courtesy of his years leading the charge against the waterfront unions in the late 1990s. He was rewarded for that campaign with a plum Telstra directorship by the Howard government, turning it into more than a decade of power at the big telco.

But the tide has turned now.



I Climate confusion

Emissions adviser Ross Garnaut pours cold water on trading scheme. Page 3

I BrisCon battle

Rebel investor claims chairman offered him money. Page 46

I Financial Services

RBS due diligence begins for ANZ. Plus: B&B Capital takeover play; 1400 in eye of Storm. From page 53



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LIFE & LEISURE: Inside Rio's samba schools. Plus: Hong Kong cuisine, vineyards for sale. REVIEW: Why the next global flashpoint could be close to home. Plus: Marc Chagall, Karl Marx... and Freddy Krueger. INSIDE TODAY



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Professionals face insurance slug

Annabel Hepworth and Duncan Hughes

Businesses are facing double-digit increases in professional indemnity insurance premiums because of a surge in negligence claims triggered by the global financial crisis and collapse of financial advisory firms. Insurance brokers said sectors with higher incidences of negligence

'As the Sons of Gwalia saga rolls on, the federal government is considering the hierarchy of creditors in a corporate failure.' - Legal Affairs, page 44

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claims — such as mortgage brokers, financial planners, property valuers, architects, engineers and others in construction — could be hit by

premium rises of up to 10 per cent, as well as more restrictive cover. As concerns mount that insurance could be more expensive and difficult to

obtain, the Australian Securities and Investments Commission has said it will review its policy on what is "adequate" indemnity cover for financial planners and other licensed financial services providers. ASIC deputy chairman Jeremy Cooper said there were suggestions the global financial crisis and high-profile financial services collapses could "make insurers more wary

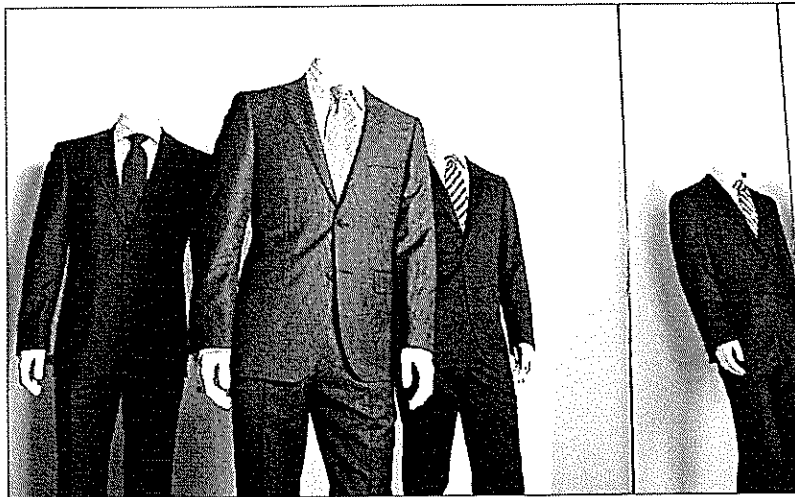
about writing these sorts of cover". His comments come amid a hardening insurance market, with the major insurers — QBE, IAG and Suncorp — having indicated there is pressure on premiums in a range of insurance classes as risk is reassessed. Aon Risk Services Australia's general manager of market services, Ross Castle, said several professions with Continued page 10

Future Fund raises heat on Telstra chair

Pamela Williams National correspondent

The Future Fund has escalated its campaign against Telstra chairman Donald McGauchie, with direct calls made by directors of the fund to members of the Telstra board. Telstra's biggest shareholder, the powerful Future Fund led by chairman David Murray, has been pressuring the combative McGauchie in recent weeks. Some fund directors, who are known as guardians, have telephoned individual Telstra directors to push their concerns over the collapse in the telco's share price since its exclusion from the government's broadband tender, as well as its long-running aggressive strategy towards the federal government. They have suggested to individual Telstra directors that this means it is time for McGauchie to be replaced with a chairman who is prepared to abandon the high-stakes political warfare that has defined Telstra since McGauchie's appointment in 2004, and that was ramped up by his hand-selected chief executive Sol Trujillo. But members of the Telstra board are understood to be pooling information about the pressure and are determined to maintain control of appointing their own chairman. Telstra is said to be infuriated that a "sovereign fund" like the Future Fund is pressing for change. Continued page 48

Street Talk, page 24



Getting the chop... after a 15-year bull run, overstuffed stockbroking firms are being forced to downsize. PHOTO: ROB HOMER

Boulevard of stockbroken dreams

The mood within Australia's stockbroking fraternity was neatly encapsulated when Ross Noye of Wilson HTM emailed clients to tell them a colleague was leaving to work in the caravan park management business of his wife's family. "While there are many of us who would love to join him, I'm sure you would all join me in wishing Hamish all the very best in his new property management career!" Noye wrote. "Caravan parks will probably be one of the few beneficiaries of the fallout of the current turmoil in capital and credit markets — they'll

They were masters of the universe. Now many are out of a job, writes Matthew Drummond.

fill up quickly with stockbrokers." Noye was only half kidding. Many industries are in the midst of a restructure, but few are in as tight a spot as stockbroking. The future of the broking giants is in doubt as their troubled parents in London and New York look to the public purse to keep them solvent.

And many smaller local players will be unable to afford new capital adequacy rules imposed by the Australian Securities Exchange. After a 15-year bull run there are too many broking firms trying to survive on too little revenue, and the process of "right-sizing" has begun. While no one knows exactly how many jobs vanished in 2008 and early 2009, estimates range from 10 to 25 per cent of the industry, amounting to 2200 to 5500 jobs. All agree that another wave is around the corner. Continued page 60

China shows early signs of a revival

Colleen Ryan SHANGHAI

China's economy grew by 6.1 per cent in the first quarter, its slowest pace since records were first published in 1992, but there are signs that the economy has bottomed as massive government spending and bank lending gains traction. There are indications that the Chinese government's 4 trillion yuan (\$815 billion) fiscal stimulus plan and interest rate cuts may be stabilising growth in the world's third-largest economy, which has been hurt by a slump in exports due to recessions in the US, Europe and Asia. China is the only major economy not expected to contract in 2009, despite the largest downturn in world trade since World War II. The World Bank recently said Beijing's plans to bolster demand by massive infrastructure spending could support growth across Asia. Data showing improved industrial production and fixed-asset investment underpinned hopes for stronger growth later this year, although many forecasters estimate it will fall shy of the 8 per cent level needed to provide new jobs and limit social unrest. The Organisation for Economic Co-operation and Development recently cut its estimate for growth in Australia's largest trading partner in 2009 from 8 per cent to 6.3 per cent. Continued page 19

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Fund raises heat on Telstra chair

From page 1

The question is whether the fund can be accused of interference — or of simply exercising its rights as shareholder. Given its 16 per cent stake, in ordinary circumstances the fund could be seen as entitled to at least a board seat at Telstra.

Telstra has a long history of internal boardroom warfare, which has healed since McGauchie became chairman. The previous board under Bob Mansfield was riven by suspicion, open plotting and campaigns to undermine both chairman and CEO. Former prime minister John Howard found out to his chagrin that any hopes he had of appointing a chairman (or delicately pointing the board in the direction of his preferred choice) in 2004 were not to be when a delegation including McGauchie visited Howard in Canberra to tell him they had in fact chosen McGauchie. Howard might have originally put McGauchie on the Telstra board in 1998, but by 2004 they did not see eye to eye.

And from that moment, things with the government went rapidly downhill. When McGauchie spurned suggestions that he should hire a prominent local executive such as David Murray as Telstra CEO, the die was cast. Instead of the big end of town, McGauchie found his man in the Midwest of America. Sol Trujillo arrived with a pre-cast strategy to litigate on regulation and hold on to Telstra's monopoly at any cost. Pumping up Telstra's ranks with own people imported from the US, Trujillo (with McGauchie joined to his hip) embarked on a four-year tirade against government intervention and regulation. Then just as dramatically, Trujillo announced he was going. Most of his US cast have packed their bags, too, stripping layers from Telstra's top management and strategy ranks.

Future Fund guardians have been alarmed by the final outcome of the McGauchie-Trujillo political combat strategy — Telstra's fading share price, its exclusion from the new broadband network, and worse, the federal government's determination to force Telstra into a new straitjacket of regulatory controls if it tries to buck the system. Now Telstra faces being carved up one way or another, an extraordinary finale for a company that swaggered in the market place on the back of its exceptional monopoly.

The high-stakes game now being played out between the Future Fund and Telstra comes after warnings to McGauchie delivered face-to-face in a meeting at the Future Fund offices in Melbourne on March 30. The message might have been delivered politely, but it was a steel fist in a velvet glove.

McGauchie was told that the fund believed the fighting with the government had to stop and that a rapprochement had to be found. And that Telstra should seek to be positive in taking advantage of the opportunities in the new broadband network. McGauchie defended his position during the meeting with Murray and other members of the Future Fund. But within a week, he had adopted startlingly conciliatory language, saying he looked forward to "productive discussions with the government at the earliest opportunity".

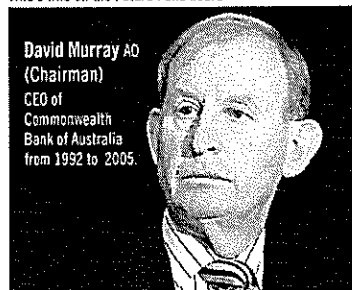
This was the same company that not so long ago had taken a minister of the crown to court (Helen Coonan), and whose official spokesman, Phil Burgess, thought nothing of insulting anyone in the government or the regulator. Trujillo had made himself a name for abuse of the government and use of Telstra's legal department (reputed to be among the biggest in the country) to litigate every regulatory step taken by the Australian Competition and Consumer Commission. McGauchie had been no slouch either, and often led the charge. In an infamous spray, McGauchie publicly accused Graeme Samuel, the head of the Australian Competition and Consumer Commission, of bias, misleading parliament, sarcasm, derision, ridicule, lack of due process and lack of objectivity.

Yesterday McGauchie refused to be drawn into a slanging match with the Future Fund. He is clearly keen for the fight not to go intergalactic. He indicated that with the ban on negotiation that was in place during the government's tender process now lifted, Telstra was simply exercising its right to sit down in discussion.

"As we have said previously, now that the

Guardians of the future

Who's who on the Future Fund board



David Murray AO
(Chairman)
CEO of Commonwealth Bank of Australia from 1992 to 2005.



Trevor C Rowe AM
Chairman of Ralshchild Australia Ltd, Chairman of QIC (Queensland Investment Corporation), chairman of the United Group Ltd, chancellor of Bond University and a director of the Australian Securities Exchange Ltd (ASX).



John Mulcahy
CEO and MD of Suncorp Metway. Previously held senior roles in CBA including group executive, investment and insurance services. Former CEO Lend Lease Property Investment Services and chief executive of Civil and Civic.

Jeffrey Browne

Partner (New York) and managing partner of Australian Offices (Melbourne and Sydney) in the legal firm Sullivan & Cromwell until recently and has extensive experience in capital market transactions.

Susan Doyle

Chair of the Australian Reward Investment Alliance (ARIA) and deputy chair and audit committee chair of the South Australian Water Corporation. Formerly held executive positions with Commonwealth Funds Management, Suncorp Metway and Insurance Australia Group.

John Paterson

31 years with JBYere & Son including as director of research, investment strategist, managing director of Vere Stockbroking and managing director of corporate finance. Director of Australian Foundation Investment Company and of Djerriwarri Investments.

Brian Watson

Executive chairman of Georgica Associates Pty Ltd, an independent private equity investment management firm. 16 years with JPMorgan & Co.

SOURCE: FUTURE FUND

original NBN [national broadband network] process has been brought to an end, Telstra welcomes the opportunity to now engage in constructive discussions with the federal government on its new \$43 billion national broadband proposal. A lot of work and detailed analysis of the proposal is still to be completed. Telstra is, as always, committed to ensuring the best interests of all our shareholders, employees and customers remain a priority."

Notwithstanding McGauchie's argument that he has always been ready to play ball, this interpretation sits uneasily with Telstra's past conduct. The speed with which McGauchie established a committee last week to negotiate with the government — and which excluded Trujillo, the CEO who had proclaimed himself a world-beater on knowledge of new networks — supports the contention that McGauchie was rattled by the Future Fund and performing a dramatic volte-face. The new committee would have the added advantage of circling the wagons around McGauchie.

The question for McGauchie now is

whether it is too late to change. In an interview published as recently as March 5, he forcefully told *The Australian Financial Review* that any attempt by the competition regulator to impose rules forcing separation on Telstra would be a complete disaster. "We have taken a view on behalf of our shareholders and customers that the regulatory framework is destructive. Throughout my life I have spent a lot of time pointing out that regulatory frameworks have been holding this country back."

Suddenly, two days after his March 30 meeting at the Future Fund with Murray, McGauchie was sotto voce by comparison, during a speech in Sydney.

"We have often said we remain interested in working constructively with the government in the delivery of broadband solutions. Telstra would have brought considerable experience and expertise to the NBN process. But it is not to be.

"We truly hope — and it is in all our interests — that the government and the chosen proponent/s get it right."

But perhaps unable to resist

a small riposte to the government, he added: "The entire process to decide the builder of the biggest infrastructure project in Australian history has been done behind high walls, without consulting the company that owns the network that is being upgraded. We simply have to take on trust that the government is fully informed about the critical technical, operational issues and national security risks entailed in the NBN before it makes its final decision. We certainly stand at the ready to assist in explaining them — although we have not been asked to do so."

Telstra has always played with the gloves off and McGauchie would be the first to admit his own penchant for this form of combat. He has had the gloves off through most of his career, especially during his years in the hugely combative National Farmers Federation and during his charge against the Australian waterfront unions.

Murray — whose career hails from the more sedate end of town but whose reputation suggests no less of a combatant — albeit usually with gloves on — is in charge of a huge stake in Telstra which is sinking in value by the day. He would see his rights to question the management of that stake as beyond question.

The Future Fund holds 16.1 per cent of Telstra, in its role as the guardian of the federal government's shareholding. Telstra was privatised in three tranches under the Howard government: T1 was sold to the public for \$3.30; T2 for \$7.40 and T3 for \$3.40.

When Trujillo was appointed chief executive of Telstra on July 1, 2005, the share price was \$5.07. The figure that has focused minds in the Future Fund is the sagging share price in the aftermath of Trujillo's multibillion-dollar overhaul plan and the drastic crash since Telstra was excluded from the broadband tender on the grounds of submitting a non-conforming bid.

The share price on Friday, December 11, last year (when Telstra was still in the running), was \$4.13. On Monday, December 15, when the news emerged that Telstra had been kicked out of the tender, the share price closed at \$3.65. On Wednesday this week, it closed at \$3.23.

The Future Fund's role vis a vis the federal government has certainly transfixed senior figures inside Telstra, and there is open speculation about whether the fund is doing the government's bidding on the McGauchie front.

McGauchie is a tough and colourful character. He was re-elected at last year's Telstra annual general meeting with more than 98 per cent of the vote. But the questions at the Future Fund and among other key investors remain. After years of combat, McGauchie has worn out his welcome in Canberra. He has lost a bitter fight with a government bent on the introduction of competition and now faces the tumult of shifting Telstra to a level playing field.

And there remains the question of whether his board stands behind him — or hangs up the phone.



The entire process to decide the builder of the biggest infrastructure project in Australian history has been done behind high walls, without consulting the company that owns the network that is being upgraded.

DONALD MCGAUCHIE, TELSTRA CHAIRMAN



I Companies round-up
Myer profit up but shoppers remain cautious. Plus: Rio threat to Chalco. From page 19

I Climate change
Labor wins support for renewable energy targets, page 3. Plus: Losing steam; Opinion. Page 63

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I BHP stoush
WA Premier takes on BHP chief with \$1bn stamp duty demand, pages 5, 19. Plus: Street Talk. Page 24

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Bank chief Ralph Norris's mea culpa over Storm Financial dealings. Page 4



FINANCIAL REVIEW

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■ Deposit base too low ■ Over-reliance on offshore money ■ Threat to economic recovery

Bank chiefs warn on funding gap

Matthew Drummond and Andrew Cornell

Bank chiefs have warned that Australia's heavy reliance on offshore funding and very low rate of deposits to loans is making the banking system increasingly vulnerable and threatening the economic recovery.

Australia, via the banking system, has long relied on foreign debt to

FINANCIAL SERVICES

'The immediate challenge, in this post-credit crisis world, is the high leverage in Australian banking.'
—Andrew Cornell; comment, page 45

- Call for commissions ban, page 4
- ANZ boss on China, page 44
- Macquarie wary on pay, page 44
- Wealth manager change, page 44

cover the current account deficit and sustain growth but as the financial system stabilises, bank chiefs and prominent corporate figures warn

that this historic reliance is a significant impediment to growth. The central concern is that banks will ultimately need to rein in

lending growth to ensure their prized AA credit ratings do not slip. This would force up the cost of credit and harm the economy's recovery.

"We are reliant on the willingness of others to lend to us," National Australia Bank chief executive Cameron Clyne told *The Australian Financial Review*. "Domestic demand for credit significantly exceeds our capacity to save."

Mr Clyne said the debate on mortgage rate rises was masking the "bigger strategic issue" of Australia's structural reliance on offshore money.

The federal government has lashed Commonwealth Bank of Australia for raising its variable mortgage rates last week. CBA cited higher funding costs as the reason

Continued page 45

Rich donors face greater tax scrutiny

Fleur Anderson

The federal government will introduce new measures to tighten tax breaks for charitable trusts and give the Australian Taxation Office greater regulatory powers over the \$1.3 billion sector.

Philanthropic groups have told Treasury they were shocked and appalled at the Rudd government's "breach of trust" in considering a plan that would force them into distributing 15 per cent of their closing value each year.

The Myer Family Office, which has established 50 prescribed private funds for clients, the Eureka Benevolent Foundation and the Arnold Foundation, a charity in memory of the late philanthropist Marion Arnold, are among those opposed to the new laws.

As part of a budget measure announced by Treasurer Wayne Swan last year, the government is intending to introduce tough new legislation next week to increase the size of compulsory distributions by the tax-free funds, boost the ATO's regulatory power over the funds and ensure regular valuation of their assets.

The government is concerned some wealthy taxpayers are exploiting the tax-free earnings of the funds for personal gain or to provide benefits to undeserving related parties.

Continued page 10

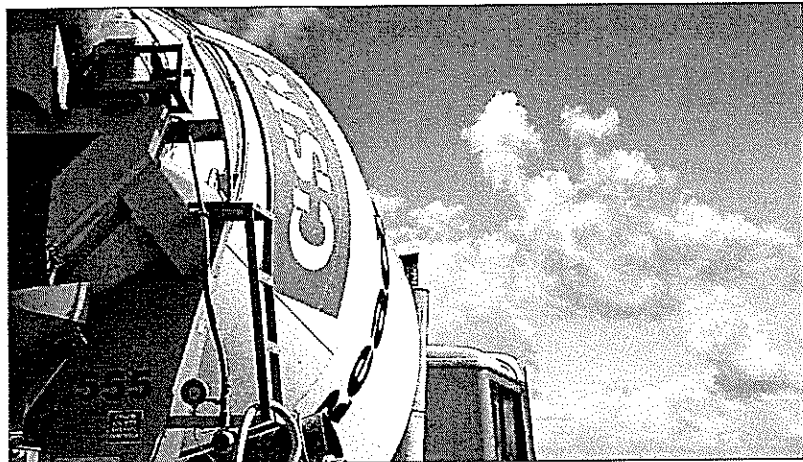


Photo: PAUL MILLER

CSR has been under pressure to boost investor returns by splitting its operations.

CSR finally cops it sweet with demerger

Jeffrey Hutton and Michael Smith

CSR will hive off its underperforming sugar division in a bid to deliver value for long-suffering shareholders and position its larger building materials division for industry consolidation.

The 154-year-old conglomerate, which was founded in NSW as the Colonial Sugar Refining company, has been under intense pressure to boost investor returns through a split of its disparate operations.

The proposed demerger, in which

END OF AN ERA

Jerry Maycock says CSR's board has been sitting on the proposed demerger since September.

—Chanticleer, back page

- Full coverage, pages 20, 21
- Street Talk, page 24

CSR shareholders will receive shares in two separately listed companies, seeks to exploit the recent sharemarket bounce, as well as improved sugar prices and signs of a turnaround in the housing industry.

Shares in the group have more than halved since early 2007.

CSR chief executive Jerry Maycock defended the timing of the plan in the face of accusations it had taken too long to execute a break-up, including criticisms of a decision to raise \$482 million in new equity late last year to pay down debt.

Guinness Peat Group, one of CSR's largest shareholders, said it was "a step in the right direction, but a decision that should have been made long ago".

Continued page 21

High noon in Telstra's boardroom

Pamela Williams
National correspondent

There were nerves around the table when Telstra's directors gathered in Melbourne on Wednesday, May 6, for the start of a two-day board meeting. This was a board that for five years had given unstinting support to the chairman, Donald McGauchie, and his belligerent chief executive, Solomon Trujillo.

But all in the room knew a seismic battle was on its way, for the next day the Future Fund was coming for lunch — and to lay down the law.

The fund was not just any shareholder in this boardroom. It was the elephant on the Telstra register, with more leverage than any other as the guardian of the federal government's huge 16 per cent stake in the company. And it was led by David Murray, a cool-eyed veteran of the banking world who was not known to resile from a fight.

It had been a wild and frenetic few weeks for a Telstra board accustomed to having the upper hand with the outside world.

The Future Fund had been relentlessly waging war behind the scenes, seeking McGauchie's head on a plate after the debacle of Telstra being ousted from one of the biggest government deals in Australian history — the national broadband network, designed to

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High noon in Telstra's

From page 1

build a high-speed fibre network across the country.

The rambunctious McGauchie, who had ruled the roost since 2004, was confident he had the numbers in his own boardroom to outmanoeuvre the visitors. But he had been forced to open the gate. Murray had been persistent in demanding a meeting between his own board of guardians and the board of Telstra. He wanted radical change.

McGauchie had resisted for weeks — instead meeting Murray and the fund alone just five weeks before. But the fund had ratcheted up the pressure, with a standing request to meet the Telstra board. Finally McGauchie caved in and the fund was invited to lunch on Thursday, May 7, during a two-day meeting that would revolve around the selection of a new Telstra chief executive. It was agreed that a subcommittee of the fund's board of guardians would attend — Murray himself, Suncorp's former chief executive, John Mulcahy, and QIC chairman and ASX director Trevor Rowe.

But if McGauchie thought he had successfully readied his army against Murray's campaign, he was soon to find that he had badly miscalculated. For the battle had now reached deep inside the Telstra boardroom and it was McGauchie's own directors who would wield the weapons before the invaders arrived.

The beheading of McGauchie would take two days before it was officially complete on the morning of Friday, May 8. But the knives for the chairman came thick and fast on the Wednesday, led by outspoken director Geoffrey Cousins, with strong support from Catherine Livingstone, John Stocker and John Zeglis. McGauchie knew he had lost control.

By the next day, David Murray was in the picture. A telephone call from a key Telstra director to Murray late on Thursday morning (ahead of the Future Fund directors arriving for lunch), assured Murray that big changes were coming later that day. McGauchie would be going, the strategy of non-stop corporate combat would be overturned, and moreover, there would be details of a new relationship with the federal government. And by the way, there was no need for the Future Fund to come to lunch now — could this meeting be postponed?

If this was an incredible phone call, then for Telstra these were incredible times. The mood inside the Future Fund had been made deadly clear. Telstra's astonishing stunt in submitting a scant 13-page, non-compliant bid for the government's broadband tender had already precipitated a fall of almost \$2 billion in the value of the Future Fund's 16 per cent stake. Were it not so serious, it would have seemed like amateur hour. It was enough to make a banker's eyes water. And it was enough to make David Murray take action.

For now — and on the basis that Telstra directors intended to finalise the departure of McGauchie forthwith — lunch between the guardians of the Future Fund and the Telstra board was cancelled. The guardians would still await a date for a future meeting with the Telstra board — perhaps chairman to chairman at first — but they would give the company some space. They had won.

The pressure was by no means over, of course. The Future Fund and other major investors — including Seven Network boss Kerry Stokes, who had amassed a half-billion-dollar investment in Telstra — would be expecting rigour from Telstra. There would be more pressure for more change if the company failed to lift its game. And yet, the Telstra board was lined with directors who had backed the flawed strategy of the past four years. Only major change could subdue the threat of more shareholder retaliation at the annual general meeting this year.

The ousting of Telstra's chairman has been one of the most remarkable coups in a top-tier Australian boardroom in many years. In just five short weeks, the Future Fund brought unbearable pressure on McGauchie and Trujillo. This was not Murray's fight alone. The board of the fund was united in its desire to see real culture change. They wanted Telstra to focus on the things that mattered — lifting shareholder value and co-operating with the government to get into the new broadband network. It was a strategy perfectly in tune

with the government's own agenda. If McGauchie ever heard a loud clang in his dreams, it was the sound of the door slamming.

Telstra directors had been stunned to read of the showdown between their chairman and the Future Fund. When *The Australian Financial Review* revealed the battle on April 16, just two weeks after McGauchie's tense March 30 meeting at the Future Fund offices with Murray and members of his board — where the thumbscrews were applied — it was the first that several Telstra directors had heard of the titanic struggle that would consume their chairman in weeks.

The news that the Future Fund had sought a meeting with the whole Telstra board infuriated Telstra directors — not because they were affronted by the fund's actions, but because they had not been told of the request. "That was an error of judgement by McGauchie," one insider said. McGauchie himself has denied that he refused a meeting between the two boards.

With the lid off the story, the Telstra boardroom found itself at the centre of a fast-escalating struggle, with no way out. Pressure was steadily wound up on Telstra directors with guardians of the Future Fund weighing in wherever they had contacts at Telstra, with letters to directors, with parallel pressure through other big institutional investors, and of course with David Murray on the phone to Donald McGauchie.

The chairman fought back, trying to circle his directors around the argument that it was not the role of a big shareholder to dictate to the board. McGauchie's PR machine sought to turn the spotlight back on Murray, trying to cast him as an arm of government, even as individual Telstra directors began to worry about the impact on their own careers. Some had government appointments elsewhere. McGauchie himself was on the board of the Reserve Bank of Australia — courtesy of a long-exhausted relationship with the former Howard government. A close confidant of McGauchie says he felt that position was under threat, too. Perhaps they were all in the gun?

Four Telstra directors were up for re-election at the AGM in November this year: Geoffrey Cousins, John Stocker, John Zeglis and Charles Macek. The thought of the

crusading Future Fund deploying its mighty shareholding in a public struggle for boardroom change at the AGM may have weighed heavily. With the exception of two directors who had joined the board only last year — John Mullen, a former DHL executive, and John Stewart, the former NAB chief executive — the rest of the board had all been there for the Trujillo ride. Catherine Livingstone and Charles Macek had respectively been on the board since 2000 and 2001.

McGauchie was now toe to toe with a foe who could push harder than he could. The Future Fund had the power — and a genuinely powerful argument to make against a weak board that had backed a strategy culminating in disaster.

The Telstra board had for years given its full-throttle support for McGauchie and Trujillo. It had backed the strategy of trying to

There was no turning back. McGauchie understood it was finished. He had been the architect of his own fall.

maintain a monopoly grip on the national phone network through a campaign of constant vilification and litigation against governments and regulators of any stripe. The board had leveraged the previous federal government's fear of public warfare as Telstra was privatised. And it had allowed Trujillo and McGauchie to act like warriors in a movie, standing on the bow of the ship with swords at the ready.

But the music had suddenly stopped. Where the Howard government had been divided among itself over the extent to which Telstra could be contained, the Rudd government had no such internal fracture when it came to facing down threats from a powerful corporate player. Rather than dealing with a split Howard government (where Telstra had enjoyed playing off ministers), the company now faced a steel wall of resistance, from Prime Minister Kevin Rudd down.

By the time Telstra directors began their

board meeting on May 7, most knew the old game was over. But not all felt strongly that McGauchie should go. Some felt that with Trujillo already on the gangplank and due to leave the country by June 30, McGauchie might change his tone. He had already responded with haste to Murray's initial pressure, tempering his language and adopting an uncharacteristically co-operative tone — at least in public. He had formed a committee to negotiate with government and pointedly excluded Trujillo.

But other directors, including the mercurial Cousins, had already abandoned McGauchie. Cousins was not to be taken lightly. His long and close relationship with former prime minister John Howard had led to initial speculation when he joined the Telstra board in 2006 that he was there as eyes and ears. Nevertheless, in subsequent years there was no outward sign that Cousins was anything other than a solid board member.

But he had a history of independent boardroom agitation at companies ranging from Optus Vision to Hudson Conway, where he quit the board in 1998 citing irreconcilable differences over corporate governance. In the mid-1990s, when Cousins was chief executive of Optus Vision, a boardroom insider told the *AFR* that he had approached then Optus Communications CEO Ziggy Switkowski during a break in a heated board meeting and told him: "Listen, you f---ing p---k. If you say one more thing, I'll throw you out that window." It was an exchange that Cousins vehemently denied but it embroidered his legend all the same.

Now in the Telstra boardroom, Cousins and Livingstone (a former chairman of CSIRO and a Macquarie Bank director) led the push. In the debate over a new chief executive, McGauchie and Trujillo had long favoured an outsider — giving the finger to those who believed the US-import Trujillo had been a disaster and that the company needed an Australian CEO to rebuild the corporate culture and introduce appropriate government relations.

The Future Fund had already told McGauchie they were strongly opposed to another imported CEO. The experiment with the hard-charging Trujillo — hand-picked by McGauchie — could not be repeated.

In the boardroom, McGauchie finally backed the chief financial officer, John Stanhope, for CEO and lost the argument. Stanhope was a strong favourite in the markets but he could not muster the numbers in the boardroom after his years of unstinting support for Trujillo. The low-key David Thodey, head of Telstra's corporate, government and large business customers, would be selected as CEO and Stanhope would be made a director in a bid to retain his skills and experience.

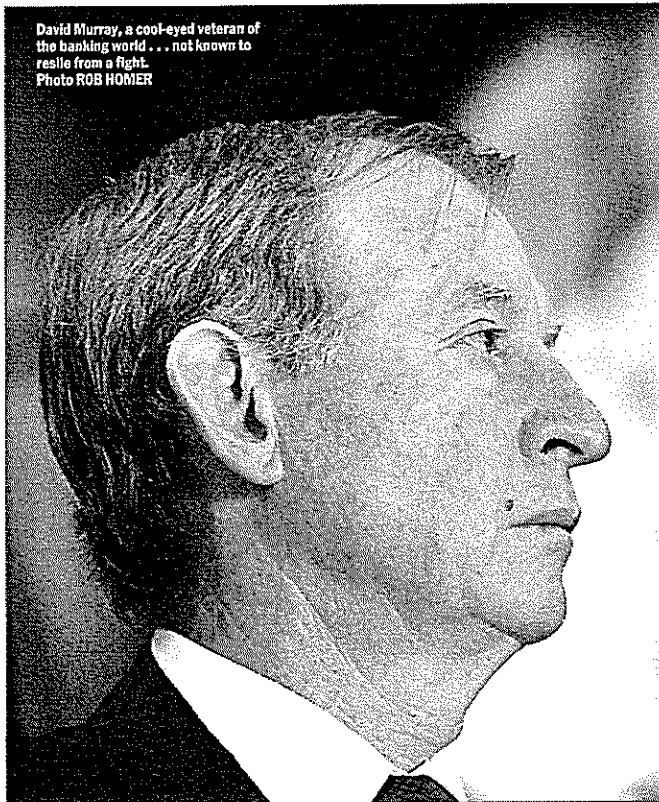
By Wednesday evening, McGauchie knew he had lost not just his preferred choice of chief executive, but his control of the boardroom, too. With the Future Fund due to come through the ramparts the next day, Telstra directors put McGauchie on notice that they wanted to continue discussing two issues the following day: first, the comprehensive failure of Telstra's strategy for the national broadband network, and second, the company's relationship with the Future Fund.

There was no turning back. McGauchie understood it was finished. He had been the architect of his own fall. But he was entitled to wonder at the loyalty of a boardroom that had also backed his and Trujillo's combative strategy, through thick and thin.

For Trujillo's part, he opposed both the appointment of Thodey and the exit of McGauchie. After years of thumbing his nose at every aspect of Australian corporate and political life, nothing was going his way. The board resolved that Trujillo should leave the company immediately to give Thodey clear space. It was a blunt finale that shocked the American.

He quit Australia six days later, taking with him a well of bitterness that would make him hurl abuse at Australia as a nation of racists — but offer not even a nod of acknowledgement that it was his own calamitous strategy that had destroyed shareholder funds, brought Telstra to the brink of an enforced break-up by the government, and finished off the chairman as well.

David Murray, a cool-eyed veteran of the banking world... not known to resign from a fight.
Photo ROB HOMER



boardroom

It was in early January this year when the Telstra board reached a fork in the road with Trujillo. During a board meeting in Las Vegas (scheduled to enable directors to visit the Consumer Electronics Show), questions steadily bubbled over about Trujillo's strategy.

In the aftermath of Telstra's being excluded from the national broadband tender three weeks before, the share price had fallen dramatically — literally overnight. The issue was red hot and some of the tempers around the board table were of a matching hue. The company appeared to have no strategy to turn things around.

One executive who attended the meeting to give a presentation to the board said later you could cut the air with a knife. Telstra director and former AT&T executive John Zeglis expressed serious concerns about Trujillo's strategy. Another executive told the *AFR* that

The issue was red hot and some of the tempers around the board table were of a matching hue.

Trujillo gave a speech to the meeting and then announced, "That's all I'm going to say", and walked out, together with Telstra's then chief operating officer, Greg Winn, his long-time colleague and confidant from the US.

Winn was on his last legs, too. And if a sign was needed of the fractious relations now ruling this one-time happy family, the board fell the stap of contempt when it held a farewell cocktail party in Vegas for Winn, who would publicly announce his departure from Telstra two weeks later. "The board held cocktails for Greg Winn and neither he nor Trujillo showed up. Things were pretty bad," a boardroom insider said.

When they all returned to Australia, the message started filtering back to the government that it was all over for Trujillo. "He just doesn't get it yet. He's in denial," one board member confided to a senior political figure. Trujillo had been paid \$13 million in his last full year and

\$30 million in cash and shares during his time at Telstra. He had been CEO for 3½ years of his five-year contract. He announced he was leaving seven weeks later, but that he would not quit the country until June 30, taking him to the close of four years. He would work until the very last minute, he claimed. But the rainfall of riches was not over yet. He would also get an extra \$3 million to take home. It was described by Telstra as a termination payment. Suddenly, on May 14, he was gone.

Donald McGauchie's departure came with all of the shock value but none of the triumphalism that had defined his own reign at the top of Telstra. He had carried this board into fierce public battle with two powerful federal governments, but it had taken them just two days to put him to the knife.

At the conclusion of their two-day meeting, the Telstra board reconvened one last time with McGauchie in the chair. Very early on Friday morning, May 8, the directors joined a phone hook-up where McGauchie — who was back on his farm in Victoria — formally resigned at the close of the call and Catherine Livingstone was formally elected. A notice was issued to the stock exchange.

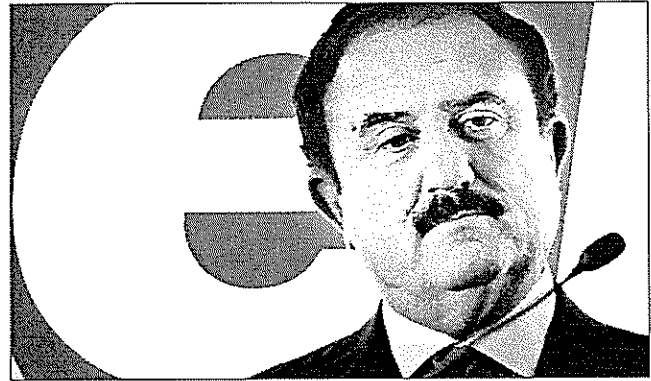
The culture had not changed, the old board was still in place, but the first act was over. It had started out with a meeting of two minds in 2005, but in the way of ageing actors unable to escape the parts they played, the McGauchie and Trujillo show had outlived audience interest.

The new chief executive, David Thodey, will have little time to show what he can do before the annual general meeting this year. More change imposed from outside is not out of the question given the campaign the Future Fund has orchestrated.

With four Telstra directors up for re-election and a vacancy to be filled after the departure of director Peter Willcox, Thodey could be working with a different board when the curtain falls in November.

He has scored the top job with a split board behind him and a question mark over how much dynamism he will bring to overhauling the culture.

David Murray and the Future Fund may not siting in the front row in November, but they will be hard at work behind the scenes.



Sol Trujillo made his mark heading Australia's biggest telco for four years.

Photo: QUENTIN JONES

No competition for this frequent flyer

A closer look at the *primer amigo* in 2005 would have told the Telstra board all it needed to know, writes Pamela Williams.

Solomon Dennis Trujillo had been the most colourful executive yet to tread the boards of Australia's top 20 companies. Since the day Donald McGauchie first met the American in the office of international head-hunters Egon Zehnder in 2005, the two had been joined at the hip. Perhaps it was the fun they saw ahead that bound them together — the chance to poke a stick at the establishment, while deploying untold billions of dollars in waves of information technology spending across the world and transforming a company Trujillo regarded as a dinosaur in a brave new world.

Trujillo had been out of work for a year when he signed on at Telstra. He had previously been chief executive of the French cell phone company Orange for a year before he abruptly quit. Before that he was CEO for two years at a small-tech firm, Graviton. He quit that job too, not long before the company collapsed. And before Graviton, Trujillo was CEO and president of US West for 18 months. He had spent several years in smaller divisions of the company before climbing to the top suite and had been chief executive of the company's telco subsidiary, US West Communications — tagged by locals as US Worst for its poor customer service. It was a sleepy Midwest local phone company that made steady profits thanks to heavy regulations that kept out competition.

When competition arrived with a government-mandated break-up of the US telco industry in 1996, Trujillo hired powerful lobbying teams, former politicians, lawyers, anything to keep open competition at bay. It was a modus operandi that would be played out in full force when Trujillo arrived in Australia almost a decade later.

When the parent company, US West, was split in mid-1998 and the stronger divisions sold off, Trujillo stayed CEO of what was left, the local phone arm that was promptly rebadged as US West Inc. Within a year he was chairman too, and he promptly set about looking for a buyer — a strategy that would make him seriously rich.

US West was sold to Qwest within six months and Trujillo quit, taking advantage of change-of-control provisions he had helped draw up in the boardroom. He was home free with bonuses, cash and share options estimated at anything between \$US60 million and \$US90 million by local media at the time.

Others did not fare so well. Qwest was soon embroiled in litigation, with accusations by US corporate regulators that accounting fraud and inflated revenue by some Qwest executives had been designed to persuade US West investors to support the takeover. The share price plunged to \$US1.11 from the merger price of \$US69, destroying the pension savings of thousands of US West retirees. *The New York Times* said it was "one of the worst mergers of recent years".

Trujillo began at Telstra as he intended to go on — with insults all round, big plans for

the future and a bulldozing public relations strategy. He had in mind a national fibre-optic network and was not putting up with governments and regulators in his way. He schmoozed with suppliers, especially those he knew well, and before long a deal was done for Alcatel to build a new \$3.4 billion network.

Trujillo was at pains to say it had nothing to do with his own years on the Alcatel chairman's council and his close relationship with then-chairman Serge Tchuruk.

But something never jelled. This defining network project was never built and seemed to become a mirage, vanishing in the sands of Trujillo's attacks on government and regulators. Telstra's share price never recovered to the \$5.07 it touched that day in 2005 when McGauchie announced his catch.

Trujillo was well praised for his Next G wireless broadband strategy but his era was stamped with controversy, from early allegations of lack of transparency in honey-pot tenders, through to witch-hunts for dissenters in Telstra's executive ranks. He imported dozens of American allies he had previously worked with and let contracts worth hundreds of millions of dollars to consultancies like Accenture he had dealt with before. Trujillo, in short, did things his own way.

He was a proud Hispanic American and he was enraged at jokes in Australia where cartoonists drew him in a sombrero. His rapid import of former colleagues from the US to stack out Telstra's executive ranks led to the group being labelled Trujillo's amigos. Yet even in the US, where Trujillo had left bitter detractors after the US West takeover, news of his ascension at Telstra provoked similar potshots. "So it's Sol Trujillo and his three amigos to the rescue? Crikey!" trumpeted one *Denver Post* columnist.

Trujillo might not have liked the ribbing but he was no slouch at dishing it out himself, and his vindictive and highly personal attacks on politicians and regulators — often issued through his volatile personal spokesman — gave no quarter.

Telstra paid a huge price for Trujillo's ever-expanding ranks of imported "talent". Some speculation in government circles has suggested the total cost of remuneration and expenses for Trujillo's foreign retinue of executives — with local housing costs and ceaseless trips back and forth to the US travelling and staying first class — could be close to \$100 million over four years.

And yet, substantial slabs of Telstra's critical transformation program were underwhelming, with reports of cost blow-outs and IT problems plaguing the centre-piece customer support and billing systems. Not a sod of earth was ever turned for the much-trumpeted high-speed fibre network. Customer complaints blossomed.

The stand-out impression left behind by Trujillo was of a man consumed by an obsession with travel and with a visceral objection to competition of any kind.

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