Michael Malone is the managing director and chief executive officer of iiNet Limited, the third largest Internet service provider of broadband services with approximately 860,000 customers nationwide.

Malone co-founded Western Australia-based iiNet in 1993, steered its transition to a public company in 1999, and acquired a bunch of ISPs to provide the economies of scale needed to offer services through the national broadband network. His most recent purchases in 2011 were South Australian-based Internode Pty Ltd and TransACT Capital Communications Pty Ltd based in Canberra.

Malone has served as president of the Western Australia Internet Association (1996-2002), as chairman and a board member of .au Domain Administration Ltd (1999-2003), and currently sits on the board of Scitech Discovery Centre Ltd. He is a member of the Australian Institute of Management and the Australian Institute of Company Directors, holds a Bachelor of Science and a Diploma of Education from the University of Western Australia, and was one of the founders in 1994 of Electronic Frontiers Association Australia.

Freelance communications journalist, Liz Fell, interviewed Malone for the TJA in late April at iiNet's Sydney office in the CBD. The interview text has been lightly edited.

TJA: Can I start by asking you to elaborate on that catchy phrase you have used in interviews with journalists, namely, ‘Get big or get out.’

Malone: Yes. This is going back a few years now, but I had seen it happen before with dial-up. We had built up ourselves very nicely in Western Australia, but when we tried expanding interstate the market was pretty much reaching saturation. We couldn't get out, basically, and by 2003 we had about 98 percent of our revenue there. We knew the problem was that if we looked long-term where broadband played out, a lot of this was going to be a scale game, and a lot of things that we wanted to do for our customers needed to be defrayed over a larger base. So if we needed to build a mail service that might cost $5 million, it was going to make a lot more sense to do that over a base of half a million customers than over a base of fifty thousand.

TJA: So it was matter of a search for scale?

Malone: It was very much about getting scale, yes.

TJA: And is it still all about scale?

Malone: I believe it is. The top four now are about 88 percent market share. A lot of people put this down to bulking up ahead of the NBN.
TJA: Surely the prospect of a national broadband network must have had something to do with this expansion or 'bulking up'?

Malone: Well, it's largely irrelevant! Don't get me wrong. I'm a big supporter of the NBN, but we're operating on basically a commoditised cost-base already. We have the same equipment in the same exchanges, the same regulated input costs for all of our broadband services as TPG and Optus and Primus and so on. We're already in a commoditised market that has reached near saturation, so how do you compete there? We had to be able to differentiate, and we weren't going to get half a million customers in just WA, so we needed to get into a national footprint.

TJA: And that has led to you buying up a swag of other, usually smaller, ISPs. Have all these purchases become iiNet subsidiaries?

Malone: As we acquired most businesses, we have folded them into iiNet unless they would be a unique differentiator and so we maintain the brand. We've got customers today who are still using the OzEmail address which we bought in 2005 but, in terms of offerings in the marketplace, a big one would be a separate web page and advertising.

TJA: I understand it was a bunch of smaller ISPs in WA that you acquired initially.

Malone: Yes, that really consolidated WA. More than half of those were tiny ISPs like us that had started up as hobbyists in the '90s. They had got to a certain point that they didn't want to manage staff, they didn't want to manage cash flows, they didn't want to deal with customers, and they couldn't capitalise the business. They just wanted to get out. In many cases, they gave us their business as long as we honoured the prepaid income from their customers. If the customer had paid three months in advance, as long as we gave that customer the three months, that was it. The price was basically unearned income. Our first real transaction was buying OIS (Online Information Systems) out of administration in 1998 and then we listed on the Australian Stock Exchange in 1999. From 2003 onwards, we said, 'Let's start expanding.'

TJA: In terms of broadband, I notice that you describe iiNet as 'second in DSL broadband', which appears very carefully worded. Where do you sit in relation to all broadband customers, including wireless?

Malone: Well, Optus has cable customers as well. iiNet sits on about 860,000 DSL broadband customers, Optus has nearly one million in total, and Telstra has two and a half million – way ahead of us. But it's much more fun being number two or three than it is being number one! Telstra has a hard job.

TJA: I saw recent ABS figures showing that there were 11.6 million Internet subscribers, and mobile wireless broadband accounted for 47 per cent of all Internet connections while DSL amounted to 41 percent.

Malone: But, of course, 90 percent may have DSL at home as well as mobile phones that do data or mobile sticks so that would mean double counting. Indeed, I was quite surprised to find out that Telstra had about 800,000 broadband subs that were MTM - machine-to-machine -which I'm putting down to those handheld ATM machines. They have a SIM in there. So in terms of wireless-only homes, the last number I've seen was about 14 percent which means it's still in the minority.

TJA: So iiNet has signed up about 860,000 fixed broadband customers?

Malone: That's pretty much all DSL. But we have now got about 40,000 customers sitting on the TransACT network that we have acquired, which includes cable and fibre-to-the-node and fibre-to-the-premises. All the rest are DSL.

TJA: Are you happy with the NBN's pricing model?

Malone: Yes. The NBN appears to have back-sold the pricing to match our existing cost. Now it may be much more complex than that, but the reason, I think, is that one of the policy objectives of the NBN is that there can't be upward pressure on pricing in the retail market. That's a Government mandate: they didn’t want to see the NBN cause prices to go up. I think one of the things they've done is to go back and see what the costs are of iiNet, Optus, and
TPG for their existing customers on their own networks, because the pricing comes in so suspiciously close that it seems a wild coincidence otherwise!

**TJA:** With the NBN offering 120 points of interconnect, will you have a presence at all of them?

**Malone:** Yes, if we want to be national. We can always buy off someone else, and Nextgen, Optus and others have said they're going to offer a wholesale service, but iiNet will be going direct.

**TJA:** So will iiNet be able to cut back on the number and therefore the cost of using Telstra exchanges for its DSL?

**Malone:** Yes. At the moment, we go into 450 Telstra exchanges so the NBN actually reduces the amount of points that we have to reach, and nearly all the components are regulated so Telstra doesn't get to set the pricing! The one that was not regulated was wholesale DSL, so for an exchange for a place like Esperance where we don't have our own equipment, we get wholesale services off Telstra.

**TJA:** Isn't the ACCC planning to regulate that price?

**Malone:** Yes, the ACCC announced just before Christmas that they're going to regulate that, and they've now put in place an interim determination for wholesale DSL. The price that Telstra was charging us was well over $40 a couple of years ago. The ACCC has reduced that to $25-$30 dollars, and that's on the first round. Now they're going to do a further detailed investigation and work out what the price ought to be long-term.

**TJA:** When do you expect that decision?

**Malone:** We're thinking August, but the ACCC have already brought in the interim determination so we're already getting lower prices.

**TJA:** I see that you're smiling when you talk about that decision. Are you pleased with the recent changes to the telecoms environment?

**Malone:** Yes, I think people look at Senator Conroy and the only thing they see is the NBN. The overhaul of the telecommunications industry that he's done in the last five years is extraordinary. Now you might argue that it wasn't the best way to do it. For instance, Paul Fletcher [Liberal MP and former Optus executive], has said words to the effect that the outcome is a good outcome, but it's a very expensive pathway to get there. But forgetting the NBN, what about some of the other things that have been done? We now have all of our input costs – unbundled local loop, wholesale line rental, line sharing, wholesale DSL – locked in for the next five years, whereas looking back over the last few years we were constantly in dispute with Telstra over pricing for everything you can imagine. Worse, it was often in arrears, so that by the time we would get a decision on, say, pricing for 2005-2008, we would be getting that in 2009, and then, of course, we would have to start the entire process over again.

**TJA:** I assume that delay was part of Telstra's strategy?

**Malone:** It's a rational strategy for Telstra. Wrapping those things up bought them time. You pointed me to an interview (Fell 2001) you did with Andrew Milner in 1991 where he commented on how we were in dispute with Telstra way back then. [Milner was managing director of the iiNet subsidiary, Chime Communications]

**TJA:** What about the policy to structurally separate Telstra's wholesale and retail arms which is taking the form of a Telstra undertaking and an ‘independent’ telco adjudicator. Are you happy with this solution?

**Malone:** We're actually pretty happy with the structural separation undertaking. There were a lot of compromises made by Telstra, and the final version that has come out now is looking a lot more sane. But, yes, the question of the 'independent' adjudicator as defined by Telstra is one of the questions that is wide open right now, and we're going to be interested to see who has been put forward.
TJA: Do you think some form of actual structural separation of Telstra will ever occur?

Malone: If the NBN is allowed to continue to completion then, absolutely, because Telstra's network will be literally separated: you've got a different company owning the fibre network and Telstra's network will be switched off.

TJA: Yet the timing of this network switch off remains unknown!

Malone: That's why the undertaking is from now until then and the fact that the ACCC has put regulation over these things for the long term gives us all a lot more certainty. We used to joke that Telstra's legal department was bigger than its marketing team! I don't know if that's absolutely true, but we need to get out of the courtrooms and out of the arbitration areas and be out trying to deal with customer issues. That's where my headspace would be!

TJA: Can I move on to your two most recent acquisitions, starting with Internode that was founded and managed by your friend, Simon Hackett. How does Internode fold into iiNet?

Malone: As a general statement, Internode's network is a sub-set of iiNet's network historically. Internode was quite a lot smaller than iiNet, which is one of the reasons Simon got out. Internode, for instance, is in 200 DSLAMs while iiNet is in 430, and iiNet last year posted $700 million in revenue while Internode did about $180 million in revenue.

TJA: Doesn't Internode use wireless networks in several locations?

Malone: It's got one in Kooyong.

TJA: What about in Armidale?

Malone: In Armidale, the NBN is doing both fibre-to-the-premises and fixed wireless, and Internode is doing both. Like iiNet, every place the NBN lit up, Internode has been in there. iiNet, for instance, is the only one that's now qualified for all three NBN technologies: fibre, wireless, and satellite.

TJA: Do you still remain close friends and discuss your thoughts and business decisions with Hackett?

Malone: Absolutely! Simon's full of ideas: it's almost impossible to stop him sometimes! I get emails every day from him with ideas, things he's come up with. He's a passionate, enthusiastic leader, and I think the people inside Internode, and also the people outside, really admire him.

TJA: Was he the one who decided it didn't make sense for Internode to compete nationally on its own?

Malone: Yes, he believed he was sub-scale. I think that regardless of the NBN, those middle-sized players are getting more and more squeezed because the big guys now have got a lot more money to spend.

TJA: Since TPG is one of the 'big guys' that has shown interest in iiNet, where does it sit in your shareholder line-up?

Malone: Number five. My family is the number one shareholder owning about 12 percent; Simon Hackett is on 7.5 percent; Westoz, Colonial and the Eley Griffith Group are all somewhere around the 7 percent mark; and TPG sits on about 6.8 percent.

TJA: Moving to TransACT, another purchase you made at the end of last year, will you keep the fibre network and VDSL that it has installed in some areas of Canberra?

Malone: TransACT have several networks. Like iiNet, they have ADSL2+ which is basically in the south half of Canberra; in the north they use a fibre-to-the-node network and Cat5 copper into the home and run VDSL over that; they also have fibre-to-the-premises in new estates so they have won the contract to be the sole provider for 14,000 homes as they're being built; and they have an HFC network in Ballarat, Geelong and Mildura.

TJA: Like Telstra, are you allowed to keep those HFC networks?

Malone: Yes.
TJA: I heard that Optus was under pressure to close its network.

Malone: Optus isn't under any pressure. Optus is gagging to be able to take $1000 per customer for shutting down their HFC. This is the deal of the century!

TJA: I thought Telstra had the deal of the century!

Malone: I mean for Optus. Telstra is getting approximately $11 billion when you add up all the benefits to them. But if you look at that as cost per customer connected, Optus is coming in at more than twice the rate!

TJA: It hasn't happened yet!

Malone: No. It has to go before the ACCC which has to rule on whether this is anti-competitive.

TJA: Are you planning to talk to NBN about the TransACT networks?

Malone: We would love to have that conversation with NBN if and when they're interested, particularly in Canberra where we have exclusive access to the power poles of 70,000 homes. Telstra is on the power poles for many of those houses as well.

TJA: How is that exclusive?

Malone: Exclusive fibre. Telstra can keep their copper there and it doesn't breach the agreement we have with ActewAGL, but no-one else can put fibre on those poles. So, in time, if NBN wants to get access to those poles to put in fibre, they need to talk to us.

TJA: When do you expect to have this conversation?

Malone: I would think they're going to await the outcome of the ACCC's decision on Optus because that's going to be a roadmap for what they are allowed to do. For instance, they're overbuilding our network in Ballarat where we have HFC to all the homes.

TJA: And you are allowed to keep that cable network?

Malone: Of course. By default, NBN will come in, build out fibre-to-the-premises to all these homes, and then rip out the copper. And then the default position is that we'll be side-by-side there with NBN in Ballarat on a much lower cost base.

TJA: Competition! What is happening in Gungahlin in the ACT where Telstra installed all those RIMs triggering a campaign led by Senator Lundy and now roll-out plans from the NBN. Does TransACT have a presence there?

Malone: We have fixed wireless. TransACT is a network builder. It has spent $280 million building those assets.

TJA: Impressive. Turning to product differentiation, are you offering triple play as well as 'quad' play, an awkward phrase?

Malone: Yes, we offer quad play, which includes mobile and a mobile phone, so we do SIMs. This [points to his phone] is an iiNet mobile phone though Optus. You're right, though. I find the quad play a little bit less natural. I think the reason it doesn't fit so easily is because broadband telephony and pay TV are both household purchases so each one services the entire house. A mobile phone is an individual purchase that is picked by the individual within the household, and I think the driver for it is quite different. For instance, we now know that about 70 to 80 percent of the decision-makers for broadband these days are women so it has now become a standard household purchase.

TJA: Like buying a fridge?

Malone: Correct. Whereas ten years ago, when it was regarded as more complex and technical, the man pulled on his overalls and went out to his shed to research what the right one was. That has shifted. Now broadband telephony and even pay TV are largely household purchases. And the handsets drive the mobile phone purchases.
TJA: I see that iiNet, among other telcos, has purchased a swag of subscription television broadcast licences from ACMA for what I'm told is about $10,000 each. The ACMA record shows that Telstra has 480 of these licences and you have 30!

Malone: Yes. We didn't know legally whether we needed to have that licence or not, but we thought it was safer. My personal opinion is that it shouldn't be necessary, though we do license content ourselves; customers get access to our freezone which offers the football club channels.

TJA: Are those from the UK?

Malone: Yes. Each of the football clubs such as Chelsea or Barcelona has their own 24 X 7 channel where they have interviews with players and games and so on. That's direct from the UK, but locally we've also done the WA Symphony Orchestra, for instance. We wanted to give customers access to something they couldn't get from other ISPs, so about ten years ago we started building this up and gradually creating a repository of content. It's all about points of differentiation.

TJA: So this free content offering began many years before you partnered with FetchTV to offer pay TV service with its set-top box?

Malone: Yes, funnily enough, we built our own box at that time.

TJA: I see that you have also built BoB which provides broadband and phone access from another sleek black box

Malone: BoB is a modem! The original BoB box was done with Belkin, which is a global company. We pulled that in-house when we created iiNet Labs and now design and manufacture our own equipment.

TJA: And for the pay TV service you now supply a FetchTV box?

Malone: Yes, the FetchTV box is a personal video recorder with a terabyte hard disc space. It has all the free-to-air stations, and that's all I can get at home because I'm on a RIM so I can't get full ADSL2+ which is a bit embarrassing!

TJA: I assume that FetchTV has the benefit of huge economies of scale because it also supplies Ananda Krishnan's Asian TV interests with its box?

Malone: Yes, Fetch is building the interface in Sydney for all the Maxis boxes.

TJA: Turning to Foxtel, what did the ACCC's approval of the Foxtel-Austar merger mean for iiNet?

Malone: Our concern, and the reason we opposed it, was not about retail competition. At the end of the day, they only overlap on the Gold Coast. Other than that you have Austar in the regions and Foxtel in the cities. So adding them all together doesn't actually change the market dynamic: it's not as if you're reducing competition in Sydney by going from two players to one player. The real concern we have is the concentration of power in buying access to and locking up the content.

TJA: I understand that Foxtel has offered undertakings on releasing its exclusive content, but they may take quite a long time to deliver…

Malone: As you say, they will take a long time, and they're weak.

TJA: Isn't there a question relating to how Telstra is positioned after this merger? Can I assess your reaction to this quote from Foxtel's ACCC Undertaking: 'The ACCC considers that: (i) Telstra's ownership of 50% of FOXTEL is likely to limit the development of competition in markets for the supply of fixed broadband and voice services.' How do you respond to that?

Malone: Yes. Telstra will be able to offer a triple play that includes broadband, phone and Foxtel services. They can do a service over the net at the moment so that you can get a cut-down version of Foxtel lite on your T-Box. We can't offer that over Telstra's infrastructure because they charge us for everything that passes over that connection…
TJA: Do you mean if iiNet buys Telstra’s wholesale DSL service?

Malone: Yes. If I’ve got a customer in the city on my network it might cost, say, $30 to get one gigabyte of data from the United States to that customer, but to get the data to a customer on Telstra wholesale can cost up to three times more.

TJA: It seems extraordinary that the ACCC has allowed the Foxtel merger if Telstra's position is likely to limit fixed broadband and voice markets.

Malone: The ACCC is very aware of this.

TJA: Yet it allowed the merger to go ahead.

Malone: Well, the rules are the wrong tool for the job. The ACCC could push so far on this, but the only real tool they have at their disposal here is 'time'. By agreeing to these undertakings now, Foxtel can expedite the transaction and get it done. If Foxtel wanted to get into a stoush with the ACCC, it will take a lot longer.

TJA: And the ACCC is up against two very powerful companies, Telstra and News Ltd.

Malone: Foxtel’s board operates in the interests of Telstra and we have seen evidence of that. They don’t necessarily act as Telstra’s pawn at all.

TJA: Moving to a quite different issue, you must be pleased with iiNet’s recent High Court win against the Motion Picture Association of America on copyright downloads of TV programs and movies. How many years did this case actually take?


TJA: Courtesy of Wikileaks, it was fascinating to read in a 2008 cable filed by the US Ambassador that the MPAA chose iiNet because it didn't want to tangle with Telstra with its ‘…demonstrated willingness to fight hard and dirty, in court and out’.

Malone: It’s odd because, traditionally, the rights holders have tackled Telstra as their first target. APRA, (Australian Performing Right Association) which represents all the global distributors, has had several cases against Telstra over the last few years. And in the 1990s it sued OzEmail, the number one ISP at the time, which led to the creation of the Internet Industry Association. So this is where the Wikileaks cable was a surprise. In some respects going after Telstra is better because if we had lost the case, or settled it, worse, it's not binding on Telstra , of course. So iiNet now enters these undertakings and Telstra goes, ‘You know what? Come sue us if you want to because we will win this one.’ Usually, going after Telstra is a better outcome for them.

TJA: According to the cable, the MPAA considered that ‘…iiNet users had a particularly high copyright download violation rate’ and that ‘… management had been consistently unhelpful on copyright infringements.’

Malone: That was the real question. iiNet, like Internode, was the first to roll out ADSL2+ across Australia, so if you wanted to get a high-speed connection, iiNet was your most likely target. The four ISPs they investigated and started pursuing were: Optus, iiNet, Internode and Exetel.

TJA: The MPAA outsourced the task of investigating and running its case to the Australian Federation Against Copyright Theft (AFACT) and it has always seemed to me that the term 'theft' is not really accurate given that the digital copy is still there after the download!

Malone: I saw an excellent article yesterday saying that in the minds of consumers they see copyright breaches as being more like trespassing than theft. So they see it as going onto their neighbour's lawn to get their ball back rather than stealing a video off-the-shelf. That resonates a bit with me.

TJA: I think at some stage you said that it wasn't so much about requiring customers to pay for a TV program or movie as the fact that they wanted it now and couldn’t get it!
Malone: Yes, you can't get it. It's a fundamental market breakdown. I'm an absolutely mad keen fan of *Game of Thrones* and the episode screened in the US is out there now live on BitTorrent to download free. It's not available to purchase anywhere. A lot of my friends are going to be watching it tonight and they, no doubt, will be talking about it at work tomorrow. And I can't get it! That's a market breakdown: I think customers would be willing to pay for this.

TJA: Do you see 'this market breakdown' as a matter of the US movie and TV studios re-thinking their business case for intellectual property because they appear to fail to take account of the global nature of the market and rely heavily on a sequence of release 'windows'?

Malone: Their view, probably correctly, is that they can maximise the revenue from the product by doing it in 'windows', so they get some revenue from movies, some from video and so on. If they offer it digitally to everyone at the same time on Day One, they'll end up with less revenue. You might say, 'So what?' But then they say that something else has to give, ‘Does that mean we make less movies or do we reduce the quality of the movies?’

TJA: So the difference between your world view and that of the MPAA is not going to disappear in the near future!

Malone: I think they start with a world view that every person on this planet is a thief who wants to steal their work if they can. I don't adhere to that view. If they make these TV shows and movies available, most people will pay for it because you want to have convenient, affordable, ready access to it, and you know it’s going to be high quality. And you know what? You also want to know whether you’re doing the right thing. Now there will still be some laggards out there who say, ‘Well, I don’t care about paying for it. I’m just going to get it from BitTorrent anyway.’ But I think there is a moral issue involved in criticising people for using BitTorrent when they have no other choice to get access to the content.

TJA: Finally, what impact has such a high profile and lengthy court battle had on iiNet?

Malone: One of the headlines that I saw was, 'Big guys line up to kick the little guy'. Winning this case has been very on-brand for iiNet because in the marketplace we try to position ourselves as the challenger that's going to go up against the big guys to give you a better result. So I see the case as being very on-brand in that respect. Now it would not have been quite so on-brand if we had lost, but the end result was something we firmly believed in.

TJA: What about the personal impact? Did you consider becoming a lawyer at any stage?

Malone: Oh, way back, for my sins, I studied law at university but I pulled out and ended up finishing a Science degree instead. I did first and second year law units, so it's actually always been a bit of a personal interest area, weirdly enough, particularly intellectual property!

TJA: Thanks a lot for your time.

REFERENCE
