



**Australian
Competition &
Consumer
Commission**

Telstra's domestic PSTN originating access service exemption applications

Discussion paper

October 2007

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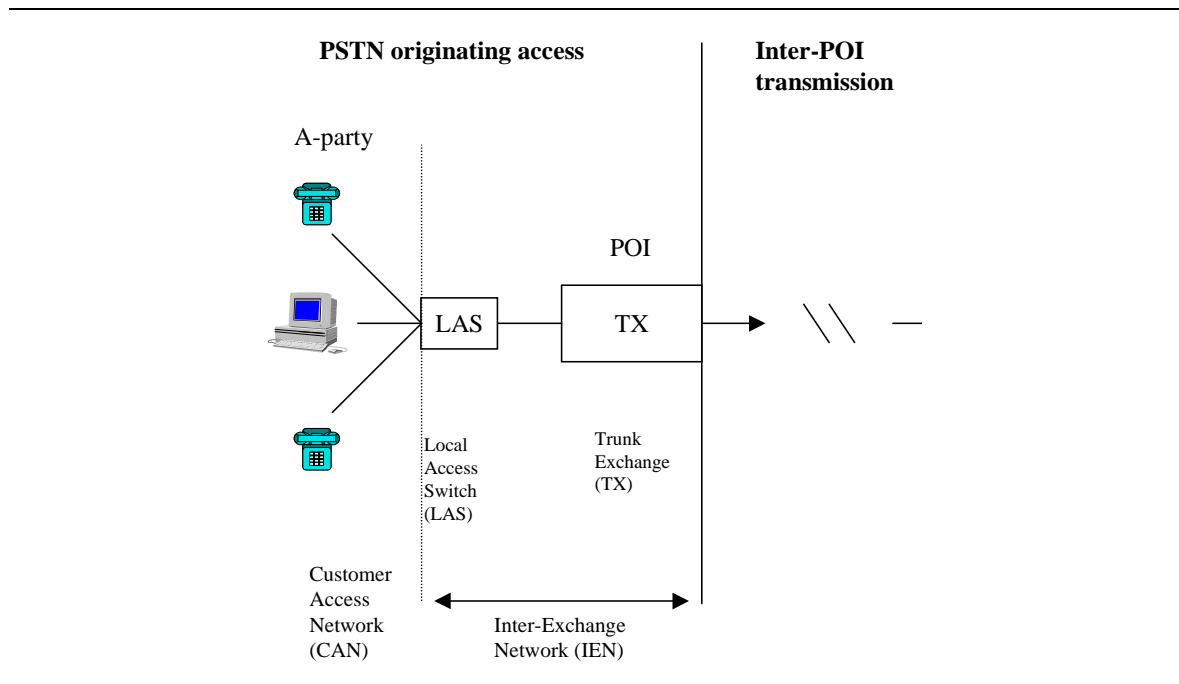
1. Introduction

The Australian Competition and Consumer Commission (ACCC) has received two applications from Telstra for individual exemptions from the standard access obligations (SAOs) under section 152AT of the *Trade Practices Act 1974* (TPA) on 8 October 2007. The exemption applications relate to the supply of the domestic public switched telephone network originating access (PSTN OA) service in:

- 17 exchange service areas (ESAs) in the five mainland Central Business Districts (CBDs) of Australia (the CBD exemption area) and
- 387 ESAs in metropolitan Australia (the metropolitan exemption area).

The PSTN OA service is the carriage of telephone calls from the calling party (the A-party) to a point of interconnection (POI) with an access seeker's network. Currently, a POI is usually located at a trunk exchange (figure 1).

Figure 1 **PSTN originating access**



Under sections 152AS and 152AT of the TPA, the ACCC has the power to determine that a specified class of carriers or a particular carrier respectively are exempt from the SAOs for a declared service. The ACCC must not make such a determination unless it considers that granting the exemption order will promote the long-term interests of end-users (LTIE) as defined in section 152AB of the TPA. An exemption order may be unconditional or subject to such conditions or limitations as are specified in the order.¹

Telstra has applied to the ACCC for individual exemptions from all SAOs for the PSTN OA declared service in 17 ESAs in CBDs and 387 ESAs in metropolitan areas

¹ TPA subsection 152AT(5).

under section 152AT. Essentially, Telstra has chosen the ESAs in the proposed exemption area based on the presence of competing infrastructure and, in particular, the presence of DSLAM infrastructure by Telstra's competitors. Each ESA in the proposed exemption area has at least one DSLAM deployed by a competitor of Telstra.

1.1 Purpose

The purpose of this discussion paper is to seek comment on Telstra's exemption applications. In particular, this paper:

- sets out background material related to the issues which the ACCC thinks should be considered in deciding whether to grant Telstra's individual exemption applications
- outlines the process and timetable for the consideration of the exemption applications
- summarises Telstra's exemption applications and
- identifies issues which are relevant to the decision about whether to grant Telstra's requested exemptions and seeks comment on these issues from interested parties.

1.2 Background

On 30 June 1997, the PSTN OA service was deemed to be a declared service under Part XIC of the TPA. At the time of the deeming of the PSTN OA, the ACCC saw the service as being central to the provision of long-distance services to end-users.²

In July 2006, the ACCC re-declared the PSTN OA for a period of three years. The ACCC considered that declaration of the PSTN OA was in the LTIE as it promoted competition, ensured any-to-any connectivity and encouraged the economically efficient use of, and investment in, infrastructure.

Declaration means that an access provider supplying the PSTN OA to itself or another person must comply with the SAOs. The SAOs are set out in section 152AR of the TPA. Among other things, they require the access provider to:

- supply the declared service to an access seeker on request
- take all reasonable steps to ensure that the technical and operational quality of the service provided to the access seeker is equivalent to that which the access provider supplies to itself and
- permit interconnection of the access provider's facilities with the access seeker's facilities to enable the supply of the declared service.

² ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final Determination*, July 2006, p. 41.

Prior to the declaration of the PSTN OA in July 2006, Telstra in its submission to the ACCC's 2006 *A strategic review of the regulation of fixed network services* claimed that there is significant competing infrastructure to its copper access network in certain ESAs. In Telstra's view:

the existence in a local exchange area of either: at least one competitor that has established or is in the process of establishing a fixed alternative such as ULL based DSLAMs, HFC cable or a fibre based network; or at least one alternative wireless network, suggests that in certain areas the customer access bottleneck does not exist.³

In the July 2006 declaration inquiry, the ACCC declared the PSTN OA on a national basis. However, the ACCC noted there was scope for regulatory forbearance from the declaration through the granting of exemptions from the SAOs in 'sub-regions' where this was shown to be in the LTIE.⁴

1.3 The exemption applications

Telstra's exemption applications were lodged with the ACCC on 8 October 2007.

If the ACCC is of the opinion that the making of an exemption order would be likely to have a material effect on the interests of a person, the ACCC must publish the application for an exemption and invite submissions from the public.⁵ The ACCC must consider any submissions received within the time it has specified when it published the application.

In the present case, the ACCC is of the opinion that the making of the exemption orders would be likely to have a material effect on a person. The ACCC understands that the PSTN OA is currently supplied in Telstra's proposed exemption area and that exempting Telstra from the SAOs would be likely to have a material effect on both access seekers and end-users. Accordingly, the ACCC is inviting submissions by way of this discussion paper.

In support of its exemption applications, Telstra submits that, within both the CBD and metropolitan exemption areas, PSTN OA no longer 'constitutes the kind of "enduring bottleneck" to which the declared access provisions of Part XIC of the Act were intended to apply.'⁶

Telstra contends that continued regulation of the PSTN OA in the exemption areas will result in 'unnecessary costs and inefficiencies, harm the competitive process and discourage efficient investment.'⁷ On the other hand, Telstra submits that granting the requested exemptions will promote competition and the efficient use of, and investment in, infrastructure in the proposed exemption areas. As a result, Telstra contends that granting the exemptions will promote the LTIE.

³ Telstra, *Submission in response to A Strategic Review of the Regulation of Fixed Network Services*, February 2006, p. 15.

⁴ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final Determination*, July 2006, p. 39.

⁵ TPA subsection 152AT(9).

⁶ Telstra, *Telstra's PSTN OA Service Exemption Applications—Supporting submission*, October 2007, p. 1.

⁷ *Ibid*, p. 2.

Telstra's exemption applications follow the release of the ACCC's second position paper of the *Fixed Services Review*.⁸ In that paper, the ACCC proposed to focus regulation on elements of the fixed-line network that continued to represent 'enduring bottlenecks.' Accordingly, the key question for the ACCC is: will the making of the orders granting the exemptions promote the LTIE?

1.4 Structure of this report

The report is set out as follows:

- Section 2 outlines the timetable and process for the public inquiry.
- Section 3 provides background information on the PSTN OA, and the developments leading up to Telstra's exemption applications.
- Section 4 provides a brief summary of Telstra's submission supporting its exemption applications.
- Section 5 sets out key issues that submissions should address in responding to this discussion paper.
- Appendix A sets out the legislative background to the access regime and the relevant matters that interested parties should consider when responding to this discussion paper.
- Appendix B attaches Telstra's confidentiality undertaking for parties wishing to access Telstra's confidential submissions.

⁸ ACCC, *Fixed services review—a second position paper*, April 2007.

2. Timetable and public inquiry process

After receiving and considering submissions from interested parties in response to this discussion paper, the ACCC expects that it will publish a draft report setting out its preliminary findings on Telstra's exemption applications. The ACCC will then provide an opportunity for comment to be made on the draft report before making its final decision. The ACCC's currently expected timetable for the inquiry is:

Deadline for submissions in response to the discussion paper	14 December 2007
Release of draft report	February 2007
Deadline for submissions in response to the draft report	March 2008
Release of final decision	May 2008

The ACCC encourages industry participants and the public to consider the issues raised in this discussion paper and to make submissions to the ACCC to assist it in considering the exemption applications. As set out in the above timetable, the ACCC is seeking submissions in response to the discussion paper by **14 December 2007**.

The ACCC has a six month period in which to make the decision to accept or reject the exemption applications.⁹ However the six month period does not include any period where the ACCC has published the application and invited people to make submissions within a specific time limit, or where there is an outstanding response to an information request.¹⁰ The ACCC may also extend the six month period by a further three months in certain circumstances.¹¹

The ACCC prefers to receive electronic copies of submissions. Electronic submissions should be in a PDF, Microsoft Word or (if appropriate) a Microsoft Excel format that contains searchable text and allows "copy-and-paste". Electronic submissions should be provided by email to:

Richard Home
General Manager
Strategic Analysis and Development
Communications Group
Australian Competition and Consumer Commission
richard.home@acc.gov.au

⁹ TPA subsection 152AT(10).

¹⁰ TPA subsection 152AT(11).

¹¹ TPA subsection 152AT(12).

The ACCC asks that any electronic submissions be copied to:

Morelle Bull
Strategic Analysis and Development
Communications Group
Australian Competition and Consumer Commission
morelle.bull@acc.gov.au

The ACCC also accepts hard copies of submissions. Any hard copy should be sent to the following address:

Richard Home
General Manager
Strategic Analysis and Development
Communications Group
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

To allow for an informed and open consultation, the ACCC prefers that confidentiality be kept to a minimum. The ACCC will treat all submissions as non-confidential, unless the author of a submission requests that the submission be kept confidential. In such a case, the author of the submission must provide a non-confidential version of the submission. Non-confidential submissions will be published by the ACCC on its website. Parties should indicate clearly where only parts of a document are confidential.

Telstra has provided a number of confidential documents in support of its application. It has stated that it will provide access to the confidential versions of its submission and attachments to agreed interested parties who have signed appropriate confidentiality undertakings. Telstra has provided the ACCC with the confidentiality undertaking it seeks to have parties sign. The undertaking is at Appendix B to this discussion paper and a Microsoft Word copy of the undertaking is available on the ACCC website. Parties wishing to gain access to Telstra's confidential documents should execute the undertaking and send it to Paul McLachlan of Telstra at Paul.McLachlan@team.telstra.com, copied to Morelle Bull of the ACCC at morelle.bull@acc.gov.au.

If Telstra does not agree to provide an interested party with Telstra's confidential submissions, that party should advise the ACCC that the party has been unable to gain access to the confidential submissions. The ACCC will then act to resolve the dispute.

Any questions about this discussion paper should firstly be directed to Morelle Bull at morelle.bull@acc.gov.au or 03 9290 1992 or Arek Gulbenkoglul at arek.gulbenkoglul@acc.gov.au or 03 9290 1892.

3. Background

This section sets out relevant background for the declared PSTN OA service. It also provides a brief overview of the ACCC's approach to regulation.

3.1 *The PSTN OA service*

The PSTN OA service relates to the carriage of telephone calls from the calling party (the A-party) to a point of interconnection (POI) with an access seeker's network. A POI is usually located at a trunk (or transit) exchange (see figure 1 on p. 3).

It is generally accepted that access seekers using PSTN OA as an input are classified into three broad categories: (1) pure pre-selection providers¹²; (2) over-ride operators;¹³ and (3) voice resellers.

Typically, PSTN OA is used by access seekers in conjunction with pre-selection or over-ride codes as an input to the supply of long distance (both national and international) and fixed to mobile (FTM) services to its customers (these access seekers are pure pre-selection providers and over-ride operators, respectively). Voice resellers are access seekers who wish to offer the full bundle of voice services to customers who will seek to acquire PSTN OA (used as an input to supply long distance services) with the local carriage service (LCS) and wholesale line rental (WLR) services (in order to supply local call services). Telstra has included international long distance, national long distance and FTM calls in the scope of the exemption applications.

The PSTN OA service is also used by these three types of access seekers to supply what Telstra terms 'special access services'¹⁴, which includes 13/1300 (local rate) and 1800 (toll free) numbers. However, Telstra has excluded special services calls from the scope of the exemption applications.

The PSTN OA service is a wholesale input. However, to provide an end-to-end service, access seekers need to acquire other elements (such as switching equipment) and services (such as transmission and terminating access) in conjunction with the PSTN OA.

The detailed service description of the PSTN OA can be found in the ACCC's *Declaration inquiry for the ULLS, PSTN OTA and CLLS*, Final Determination, July 2006.¹⁵

¹² Under this arrangement, the customer's phone line is connected with one provider but is set to automatically direct all mobile, national long-distance and international calls through the pure pre-selection provider. The customer does not need to dial an access code.

¹³ Under this arrangement, the customer's phone line is connected with one provider but mobile, national long-distance and international calls are provided by an override service provider. With an override service, the customer dials a 4 digit access code immediately before dialling the number to access the service.

¹⁴ Telstra, *Telstra's PSTN Originating Access Exemption Applications – Supporting submission*, July 2007, p. 9.

¹⁵ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final Determination*, July 2006, Appendix 3.

3.2 The ACCC's decision to declare the PSTN OA

The PSTN OA service was declared by the ACCC in July 2006 as part of its *Strategic review of the regulation of fixed network services* (Declaration Inquiry).¹⁶ The PSTN OA had previously been deemed to be declared in June 1997.

In the July 2006 Declaration Inquiry, the ACCC considered that declaration of the PSTN OA on a national basis would promote competition in various wholesale and retail markets and would encourage efficiency in infrastructure usage and investment.¹⁷

In reaching this view, the ACCC noted that Telstra's PSTN network remains the dominant source of customer access and therefore underpins the provision of most downstream voice services. The ACCC also concluded that there were substantial barriers to entry in deploying access infrastructure and this was likely to limit the extent of network deployments in the foreseeable future.¹⁸

The ACCC considered that competing networks in metropolitan and regional areas were not yet sufficiently developed to provide for competition at the originating access level, therefore access seekers were reliant upon Telstra for originating national long distance, international long distance and FTM calls for the foreseeable future (as well as LCS).¹⁹

The ACCC considered revoking the PSTN OA declaration in CBD areas. However, given the uncertainties surrounding alternative networks and, in particular, future next generation network (NGN) developments such as the transition to an IP-based core network, revocation was then thought to be premature.²⁰

The ACCC considered that declaration of PSTN OA would encourage efficient use of infrastructure by facilitating product differentiation and the creation of new and innovative bundles. The ACCC stated that this would lead to price competition in the supply of voice services, which would in turn enhance productive and allocative efficiency.²¹

The ACCC also considered that declaration would encourage efficient investment in infrastructure by facilitating market entry and reducing the risks associated with infrastructure deployment by access seekers. Further, the ACCC found that Telstra's legitimate commercial interests would not be harmed from continued declaration of the PSTN OA service.²²

¹⁶ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final Determination*, July 2006.

¹⁷ *Ibid.*, p. 6.

¹⁸ *Ibid.*, p. 52.

¹⁹ *Ibid.*, p. 51.

²⁰ *Ibid.*, pp. 51–52.

²¹ *Ibid.*, p. 46.

²² *Ibid.*, pp. 46–50.

3.3 Undertakings and arbitrations

Since 1997, Telstra has lodged five access undertakings in relation to the domestic PSTN originating and terminating access (PSTN OTA) services.

The first PSTN OTA undertaking was lodged with the ACCC on 7 November 1997. The ACCC rejected this undertaking on the basis that the terms and conditions for non-price issues were not reasonable.²³ The second PSTN OTA undertaking was lodged with the ACCC in October 1999, following the release of the ACCC's decision to reject the first undertaking. The ACCC rejected this undertaking on the basis that the price terms and conditions were not reasonable.

Telstra then lodged a set of access undertakings with the ACCC on 9 January 2003 specifying the price-related terms and conditions upon which it undertook to meet its SAOs to supply the PSTN OTA, the Unconditioned Local Loop Service (ULLS) and the LCS (together referred to as the core services). In October 2003, the ACCC published its Model Price and Non-Price Terms and Conditions for core services, which included model prices for the PSTN OTA and LCS. Telstra subsequently withdrew its 9 January 2003 undertakings and submitted replacement undertakings on 14 November 2003. These undertakings were intended to cover the period to 30 June 2006. The PSTN and LCS undertakings were accepted by the ACCC in December 2004.

Telstra lodged a subsequent PSTN OTA and LCS undertaking on 22 March 2006 specifying price related terms and conditions upon which it would undertake to meet its applicable SAOs. The ACCC rejected the undertaking because, although the terms and conditions specified in the undertaking were consistent with the applicable SAOs as required by paragraph 152BV(2)(b) of the TPA, the ACCC was not satisfied that the terms and conditions specified in the undertaking were reasonable.

The PSTN OA service has been the subject of arbitrations since it was first declared in 1997. Currently, the ACCC is arbitrating three access disputes between parties about the terms of access to the PSTN OA.²⁴

3.4 Fixed services review: second position paper and proposed audit of competitive infrastructure

Since the ACCC's decision to declare the PSTN OA in July 2006, there have been two significant ACCC reports which are relevant to the assessment of these exemption applications.

²³ ACCC, *Assessment of Telstra's Undertaking for Domestic PSTN Originating and Terminating Access — Final Decision*, November 1997.

²⁴ A list of current access disputes is available on the ACCC's website at: <http://www.accc.gov.au/content/index.phtml?itemId=635059>.

Fixed services review: second position paper

In April 2007, the ACCC released a second position paper in its ongoing *Fixed Services Review*.²⁵ The primary purpose of the position paper was to outline a framework for the review of existing service declarations.

In the second position paper, the ACCC considered that *ex ante* access regulation under Part XIC should focus on those elements of the fixed-line network that continue to represent ‘enduring bottlenecks’. The ACCC considered that an enduring bottleneck would generally refer to a network element or facility that exhibits natural monopoly characteristics and is ‘essential’ to providing services to end-users in downstream markets in a way that promotes the LTIE.²⁶

Where an enduring bottleneck does not persist, the ACCC stated that it will be inclined to progressively withdraw *ex ante* access regulation where it is confident that declaration is not required to promote the LTIE. The ACCC noted that its proposed approach was:

... also based on the principle that, for services or network elements which are not enduring bottlenecks, competitors that do not wish to invest in their own infrastructure will, more than likely, have the opportunity to enter into commercially negotiated arrangements for access with third parties (or the incumbent) without the need for *ex ante* regulatory intervention. In this regard, the withdrawal of access regulation at certain network layers does not necessarily suggest that these forms of competition will cease, or that their price will necessarily be raised excessively by the access provider. Rather, it is recognition that *ex ante* regulation is no longer required to ensure that these services are competitively priced at or near their underlying costs.²⁷

The second position paper also considered the geographic dimension to market definition employed by the ACCC in the past and its future application. The ACCC noted it may be more meaningful to begin its analysis by considering geographic units at the exchange level (given this would be the field for demand-side substitutability).²⁸ Exchange level geographic units could then be aggregated together in the same ‘class’ of market if they exhibit ‘similar’ competitive characteristics.

In addition to this particular aspect of market definition, the ACCC considered more generally the approach to be taken to the assessment of competition.²⁹ The ACCC identified a number of structural and behavioural characteristics that it would examine in making a competition assessment:

- structural factors, including market concentration, the nature of competition and the underlying costs of service provision
- the potential for competition, including planned entry, the size of the addressable market, and the existence and height of barriers to entry, expansion and exit in the relevant markets

²⁵ ACCC, *Fixed Services Review—a second position paper*, April 2007.

²⁶ *Ibid*, pp. 16–17.

²⁷ *Ibid*, p. iii.

²⁸ *Ibid*, p. 40.

²⁹ *Ibid*, pp. 40–49.

- the dynamic characteristics of markets, including growth, innovation and product differentiation, as well as changes in costs and prices over time
- the nature and extent of vertical integration in the market.

The second position paper also proposed to conduct a comprehensive review of fixed service declarations commencing in mid 2008.³⁰

While the ACCC has sought and received submissions on the positions outlined in the second position paper, and is still considering those submissions, the paper clearly provides relevant guidance for the ACCC's consideration of Telstra's exemption applications.

Audit of competitive infrastructure

The ACCC has recently issued a discussion paper proposing a new record keeping rule (RKR) which would require relevant telecommunications infrastructure owners to identify the key components and locations of their infrastructure assets.³¹ The discussion paper sought the views of interested parties on the proposed approach.

In September 2007 the ACCC issued an RKR to Telstra. This RKR primarily requires the quarterly reporting of ULLS and LSS take-up, and implements the first phase of the infrastructure audit.

³⁰ Ibid, pp. v, 30.

³¹ ACCC, *Proposed audit of telecommunications infrastructure assets—discussion paper*, March 2007.

4. Summary of the exemption applications

This section provides a brief summary of Telstra's submission supporting its exemption applications.

Telstra has submitted two separate exemption applications to the ACCC on 8 October 2007 for the PSTN OA service. One exemption application covers 17 ESAs in CBD areas while the second covers 387 ESAs in metropolitan areas.

Telstra provided a single submission in support of both exemption applications.³² Telstra has also provided 15 annexures to its supporting submission. Public versions of 7 annexures have been supplied by Telstra. The remaining 8 annexures will be provided by Telstra to interested parties upon signing Telstra's confidentiality undertaking (available at appendix B).

If Telstra does not agree to provide an interested party with the confidential versions of Telstra's submissions, that party should advise the ACCC that the party has been unable to gain access to the confidential versions. The ACCC will then act to resolve the dispute.

4.1 Exemption area

The CBD exemption area and the metropolitan exemption area (the combined exemption area) cover a total of 404 ESAs. Telstra states that the combined exemption area contain just over 5.6 million PSTN services in operation (SIOs) representing 280,000 SIOs in the CBD exemption area and almost 5.6 million SIOs in the metropolitan exemption area.

Telstra is seeking exemptions from all of the SAOs in the combined exemption area.

4.2 Presence of competing infrastructure

Telstra's basis for choosing the 404 exchanges in its combined exemption area is the presence of competing DSLAM-based infrastructure.³³ Telstra submits that, in addition to competing DSLAM-based infrastructure, there is significant infrastructure present in the combined exemption area pointing to HFC cable networks, fixed wireless networks and (to a lesser extent) mobile networks as providing alternatives to Telstra's PSTN.³⁴

Telstra notes that the presence of competing infrastructure is more prevalent in the CBD exemption area, compared with the metropolitan exemption area. For instance, Telstra states that there are around 20 companies operating 55 fibre networks and 22 companies operating 37 wireless networks in the CBD exemption area.³⁵ It also

³² Telstra, *Telstra's PSTN Originating Access Exemption Applications – Supporting submission*, July 2007, p. 4.

³³ *Ibid*, p. 16.

³⁴ *Ibid*, pp. 16–23.

³⁵ *Ibid*, pp. 17–19.

submits that there are at least four DSLAM-based competitors in each of the ESAs in the CBD exemption area.³⁶

In the metropolitan exemption area, Telstra states that there is at least 1 DSLAM-based competitor in each ESA.³⁷ Telstra submits that around 80 per cent of ESAs have two or more DSLAM-based competitors and around 38 per cent of ESAs have four or more DSLAM-based competitors.³⁸ Telstra also claims that in 87 per cent of ESAs, customers can choose between at least two network providers for voice services (DSLAM-based, cable or fixed wireless).³⁹

Telstra asserts that competing infrastructure in both the CBD exemption area and the metropolitan exemption area will continue to expand over time.

In its submission, Telstra argues that it has only used publicly available data sources to estimate the presence of competitive infrastructure and that its estimates about the presence of competitive infrastructure are likely to be conservative.⁴⁰

4.3 Extent of competition

Telstra submits that the markets in which the PSTN OA service is supplied are contestable and workably competitive. Telstra contends that:

- over time, market shares have changed and current market offerings have developed
- there are numerous substitution possibilities (including VoIP and mobile telephony services) to the PSTN network and
- there are no material barriers to entry for potential competitors willing to enter the market — driven primarily by the economics of DSLAM-based competitor entry.⁴¹

Telstra states that the above three contentions mean there are sufficient constraints on its pricing and provisioning of the PSTN OA service, such that in both the CBD exemption area and the metropolitan exemption area, the exemptions are clearly justified.

4.4 Effect on downstream markets

In its submission, Telstra sets out the likely impacts of the exemptions, if granted, on downstream markets.

In the absence of declaration, Telstra states that a pure pre-selection provider would ‘face little or no impediment to changing its business model to provide a bundled

³⁶ Ibid, p. 19.

³⁷ Ibid, p. 22.

³⁸ Ibid, p. 23.

³⁹ Ibid, p. 24.

⁴⁰ Ibid, p. 20.

⁴¹ Ibid, p. 33.

product through ULLS-based infrastructure.⁴² Alternatively, if the pure pre-selection provider exited the market, Telstra submits that this would have no impact on downstream competition given the ‘de minimis’ presence of these providers.

Similarly in relation to over-ride operators, Telstra asserts that, given the use of over-ride services has declined markedly in recent years, if these operators exited the market, it would have no impact on downstream competition.

Telstra states that voice resellers, as the largest category of PSTN OA users, are in the strongest position to self-supply using ULLS. Telstra submits that there would continue to be constraints on the pricing of the PSTN OA service if the exemptions were granted, at both the wholesale and retail levels.⁴³

4.5 *Costs of regulation*

Telstra submits that there are a number of costs in continuing regulation. Telstra notes that ‘extensive alternative infrastructure to Telstra’s PSTN’ within its combined exemption area is driving competition in the market for fixed-line voice services.⁴⁴ Telstra asserts that, in light of this competition, continued regulation would be harmful and costly.

Telstra contends that regulation of the PSTN OA is costly on four key grounds:

1. Regulated access prices tend to truncate the reward of a successful investment without reducing losses from unsuccessful investments, thereby reducing incentives to invest.
2. Regulation would ‘provide a crutch to passive competitors unwilling or unable to invest in infrastructure and to commit to the rigours of a competitive market.’⁴⁵
3. Regulation creates arbitrage possibilities for access seekers where access prices are set by regulators as opposed to the prices that would occur in an efficient and competitive market. Such arbitrage possibilities would distort the market.
4. The likelihood of regulatory error is asymmetrical – that is, regulated prices will tend to be lower than the efficient level, rather than higher than the efficient level.⁴⁶

Telstra submits that, overall, these impacts of regulation will tend to inefficiently distort investment incentives by imposing two classes of costs:

- regulation per se, even if perfectly executed, imposes transaction, compliance and administrative costs and

⁴² Ibid, p. 46.

⁴³ Ibid, p. 48.

⁴⁴ Ibid, p. 50.

⁴⁵ Ibid, p. 51.

⁴⁶ Ibid, pp. 50–53.

- even with the best intent and most skilful execution possible, there is inevitably an element of regulatory error which itself imposes costs.⁴⁷

4.6 Effect on the long-term interests of end-users

The final part of Telstra's submission sets out its views on the effect of the granting of the exemptions on the LTIE.

Promotion of competition

Telstra states that facilities-based competition is preferable to regulated access of the PSTA OA as it leads to greater price competition, greater service innovation and competition for supply over a wide range of markets.⁴⁸ Telstra contends that the granting of the exemptions will promote facilities-based competition, given the extensive roll-out of alternative infrastructure in the combined exemption area, and asserts that efficient and workable competition already exists in markets in which the PSTN OA is supplied and that competition in these markets would improve further in the future.

Telstra submits that the granting of the exemptions will not compromise competition due to the presence of supply-side substitution in the upstream input market.⁴⁹

Any-to-any connectivity

Telstra submits that the granting of the exemptions will not have any bearing on any-to-any connectivity.⁵⁰

Efficient use of and investment in infrastructure

Telstra submits that granting the exemptions will promote facilities-based competition by encouraging greater investment in competing infrastructure, and will promote the efficient use of, and investment in, infrastructure. In this regard, Telstra relies on three key submissions:

- The widespread deployments of DSLAMs and the supply of services equivalent to the PSTN OA demonstrates that alternative supply is technically feasible in the combined exemption area
- Telstra's legitimate commercial interests will be enhanced by the granting of the exemptions allowing it greater commercial freedom and flexibility
- The incentives for investment will be improved by the granting of the exemptions because the risks and potential market distortions of regulation will be removed.⁵¹

⁴⁷ Ibid, pp. 53–54.

⁴⁸ Ibid, p. 56.

⁴⁹ Ibid, p. 59.

⁵⁰ Ibid, p. 61.

5. Questions about the exemption applications

The ACCC must not make an order granting the exemptions unless it is satisfied that the making of the order would promote the LTIE.⁵² In assessing the exemption applications, the ACCC will take particular account of, among others, two key questions:

- Without the declared PSTN OA, will competition be effective in downstream retail markets?
- How will granting the exemptions affect the incentives for rollout of infrastructure, such as DSLAMs, by telecommunications companies?

These questions will be informed by the findings on a number of key issues. This section sets out the particular issues the ACCC would like interested parties to focus on in providing submissions to this discussion paper.

The ACCC will decide whether to grant the exemptions after having regard to the LTIE matters in the legislation (as discussed in Appendix A to this discussion paper). Submissions should therefore address the legislative matters, where possible, in responding to this discussion paper. Interested parties may also wish to provide submissions on relevant issues not directly raised in the questions in this section.

5.1 *Market definition*

In considering whether the granting of the exemptions would be in the LTIE, the ACCC firstly needs to define the relevant markets. In particular, the ACCC needs to determine whether granting an exemption would be likely to promote competition in the markets for listed services under section 152AB of the TPA. Typically, the ACCC considers the product, geographic, functional and temporal dimensions of a market. The relevant markets could include:

- the market or markets where the declared service is, or can be, supplied
- the market or markets in which competition may be promoted, including downstream and upstream markets.

As noted in the second position paper of its *Fixed Services Review*, the ACCC must consider both demand and supply-side substitutability constraints. From the demand-side, a relevant consideration is to what extent consumers can substitute to other services (or sources of supply) in the event of a significant price rise, or equivalent exercise of market power, by an incumbent firm. From the supply-side, a relevant consideration is the extent to which (and how quickly) firms could switch or expand supply in the event of a significant price rise, or equivalent exercise of market power, by an incumbent firm.

⁵¹ Ibid, p. 62.

⁵² TPA subsection 152AT(4).

The ACCC is also guided by the ‘commercial realities’ of a particular industry (such as actual patterns of supply) to ensure that the market(s) identified accurately reflect the arena of competition. The ACCC will also take into account that declarations, exemptions and the overall telecommunications regulatory regime might affect the dimensions of particular markets.

The ACCC considers generally (and Telstra has submitted in its supporting documents)⁵³ that market definition is not necessarily a definitive exercise for processes under Part XIC.⁵⁴ Rather, market analysis provides an analytical framework to examine the likely effect of granting an exemption.

In the July 2006 Declaration Inquiry, the ACCC considered that the relevant markets in which the PSTN OA may promote competition included:

- wholesale and retail supply of fixed voice services and
- retail supply of mobile telephony services

The ACCC also noted in the July 2006 Declaration Inquiry that telecommunications markets are in a state of flux and that the markets, or certain dimensions of the markets, in which the PSTN OA is likely to promote competition may change over time.

An aspect of market definition that is particularly relevant to the exemption applications is the *geographic* dimension. The ACCC has previously stated that analysis at the ESA level provides a useful starting point to consider the growth of competition in different geographic regions, however, each individual ESA may not be a separate market. The ACCC considered that another important consideration would be how different geographic areas would be aggregated together to form a ‘class’ of markets that have ‘similar’ competitive conditions. Indicators which the ACCC considered could be used to aggregate geographic areas included structural factors such as the number of facilities-based competitors, population density thresholds, and evidence of price discrimination or price correlation.⁵⁵ For these exemption applications, Telstra has chosen to include ESAs in the combined exemption area based on the presence of at least one DSLAM-based competitor in the exchange.⁵⁶

A consideration relevant to the *functional* dimension of the markets is the relationship between the upstream ULLS and line sharing service (LSS), which are used to provide services in conjunction with access seeker infrastructure deployments, and the downstream PSTN OA service.

⁵³ Telstra, *Telstra’s PSTN OA Service Exemption Applications—Supporting submission*, October 2007, p. 13.

⁵⁴ ACCC, *Fixed services review—a second position paper*, April 2007, p. 32; ACCC, *Local services review—final decision*, July 2006, pp. 28-30.

⁵⁵ *Ibid*, p. 40.

⁵⁶ Telstra, *Telstra’s PSTN OA Service Exemption Applications—Supporting submission*, October 2007, Annexure A.

The ACCC considers that the various dimensions of markets—product, functional, geographic and temporal—are not discrete and that conclusions on one dimension may affect the consideration of other dimensions. For example, to the extent that wireless and fixed network voice and/or broadband services were considered part of the same product market, the consideration of the geographic dimension at the exchange level might be less significant. This would be because wireless and mobile network coverage is not particularly related to ESA-level deployment of infrastructure. Decisions to invest in mobile or wireless networks might be based on a larger geographic unit. Similarly, on the demand side, consumers would not be constrained to switching to services provided from their exchange.

Questions for interested parties:

- What are the relevant markets that would be affected by the granting of the exemption?
- How should these markets be defined? What evidence of demand and supply-side substitutability supports that market definition?
- Are the markets identified by the ACCC in the July 2006 Declaration Inquiry still relevant? Are there any other markets that the ACCC should/should not consider?
- Is Telstra’s approach to defining its exemption area—at least, one DSLAM-based competitor in each exchange—an appropriate one?
- Is the data that Telstra used, based on publicly available information, sufficiently robust to allow the ACCC to be confident about the deployment of DSLAMs in the proposed exemption area?
- What further data, if any, would the ACCC need to extent of competition in the proposed exemption area?

5.2 Promotion of competition

Once relevant markets have been defined, it will be necessary for the ACCC to assess competition in the relevant markets. This analysis should not merely be a static assessment but should also take into account dynamic factors such as the potential for sustainable competition to emerge and continue, and the extent to which the threat of entry or expansion constrains pricing and output decisions.⁵⁷ As noted above, the effect of granting the exemptions on competition in downstream retail markets is likely to be particularly relevant.

The ACCC noted in its second position paper that, where competition in relevant markets is determined to be ‘effective’, then continued declaration of a service is not likely to promote competition or the LTIE.⁵⁸ The ACCC considers that ‘effective’ competition is the appropriate benchmark for telecommunications markets and that perfect competition will be unlikely in fixed-line telecommunications markets.

⁵⁷ ACCC, *Fixed services review—a second position paper*, April 2007, p. 40.

⁵⁸ *Ibid.*

The ACCC has previously reviewed the concept of ‘effective competition’. Given the practical limitations associated with the theory of perfect competition, effective competition is a more practical concept. Definitions of such a standard are always difficult, but some characteristics can be highlighted.⁵⁹ Effective competition:

- is more than the mere threat of competition—it requires competitors active in the market, holding a reasonably sustainable market position⁶⁰
- requires that, over the long run, prices are determined by underlying costs rather than the existence of market power (a party may hold a degree of market power from time to time)
- requires that barriers to entry are sufficiently low and that the use of market power or collusive behaviour will be competed away, so that any degree of market power is only transitory
- requires that there be ‘independent rivalry in all dimensions of the price/product/service [package]’⁶¹ and
- does not preclude one party holding a degree of market power from time to time, but that power should ‘pose no significant risk to present and future competition’.⁶²

These five factors are indicators of the extent to which competition constrains market participants to supply products and services of a given quality at prices that are based on efficient costs.

The ACCC considers that, where efficient, facilities-based competition is likely to be both effective and promote the LTIE. This is because rivals are able to differentiate their services and compete more vigorously across greater elements of the network and supply chain. The ACCC also considers that facilities-based competition is more likely to lead to enduring benefits.⁶³

As noted above in section 3.4, the ACCC considered in its second position paper that the following factors are relevant to a competition assessment:

- structural factors, including market concentration, the nature of competition and the underlying costs of service provision
- the potential for competition, including planned entry, the size of the addressable market, and the existence and height of barriers to entry, expansion and exit in the relevant markets

⁵⁹ This is not intended to be an exhaustive characterisation of effective competition.

⁶⁰ Olivier Boylaud and Giuseppe Nicoletti, ‘Regulation, market structure and performance in telecommunications’, *OECD Economics Studies*, no. 32, 2001/1.

⁶¹ *Re Queensland Co-operative Milling Association Ltd and Defiance Holding Ltd (1976) 25 FLR 169.*

⁶² *Ibid.*, p. 42. In general, however, market power must not be used in a way that would constitute a ‘misuse of market power’.

⁶³ *Ibid.*, p. 41.

- the dynamic characteristics of markets, including growth, innovation and product differentiation, as well as changes in costs and prices over time
- the nature and extent of vertical integration in the market.

In considering these factors for the purposes of these exemption applications, the ACCC will have to examine the market in which the PSTN OA is supplied, and the relevant upstream and/or downstream markets.

Structural factors

At present, carriers can provide long distance and FTM calls using PSTN-based services, ULLS services or its stand-alone network. As noted above, PSTN-based services comprise pre-selection providers, override operators and voice resellers.

In 2005-06, around 87 per cent of voice services were provided by Telstra's copper customer access network (CAN). More specifically, Telstra has a dominant role in providing long distance and FTM services with an estimated market share of 65 per cent in national long distance, 52 per cent in international and 65 per cent in FTM.⁶⁴

In its supporting material for its exemption applications, Telstra points towards the presence of various forms of competing infrastructure in the combined exemption area. Telstra submits that ULLS-based operators pose a competitive constraint on PSTN-based services. Telstra also submits that cable-based networks and fixed wireless networks provide a competitive constraint on Telstra's pricing for the PSTN OA and that 'the presence of these alternative networks can only serve to reassure the Commission of the desirability of granting the exemptions.'⁶⁵ Telstra also asserts that VoIP and mobile services are effective substitutes to PSTN services.

Telstra submits that, structurally, the presence of one competitive DSLAM is a sufficient signal of competitive strength in an exchange area.

The ACCC considers that evidence of the replicability of the PSTN OA would help to determine the question of whether the granting of the exemptions would promote competition. There is some evidence to suggest that PSTN OA services are replicable by access seekers using the ULLS. The ACCC understands, for example, that companies such as Optus currently supplies PSTN voice services over the ULLS.

The ACCC is interested in the extent to which LCS and WLR services are bundled with PSTN services. The ACCC also understands that there are no technical reasons why a PSTN service could not be used to provide local calls.

The ACCC also considers that it would be relevant to differentiate between ULLS SIOs and LSS SIOs to consider the relative competitive dynamic. Such a distinction recognises that a ULLS-based competitor could provide a PSTN-based service and an xDSL service to customers whereas an LSS-based competitor with an MSAN could

⁶⁴ ACCC, *Telecommunications competitive safeguards for 2005-06*, April 2007, p. 30.

⁶⁵ Telstra, *Telstra's PSTN OA Service Exemption Applications—Supporting submission*, October 2007, p. 24.

provide xDSL services but could only supply voice services using VoIP technology rather than PSTN.

Questions for interested parties:

The ACCC seeks comment from interested parties on a number of issues relevant to **structural factors**. The ACCC would like interested parties to answer these questions separately for the two exemptions areas — first in relation to the CBD exemption area and then in relation to the metropolitan exemption area.

First, the ACCC is interested in the current state of play in the relevant markets.

- What alternative providers to Telstra of PSTN OA currently operate in the wholesale market? Do these providers offer any significant competitive constraint on the pricing of the PSTN OA?
- What infrastructure do alternative wholesale providers use?
- Is competition in downstream markets currently effective?
- Are Telstra's statements about the low barriers to entry to DSLAM-based infrastructure accurate?
- Are DSLAMs a significant competitive presence for the provision of wholesale and retail PSTN services? What percentage of DSLAMs currently would be capable of providing traditional voice services as opposed to only DSL broadband?
- Do cable and fixed wireless networks or VoIP services or mobile services provide a material constraint on the pricing of the PSTN OA? Is there any evidence of substitution between all these options?
- What are the relevant trends in retail markets for PSTN voice services? Is there evidence of end-users switching away from PSTN voice services?

The ACCC is interested in what would happen in the absence of a declared PSTN OA service.

- In the absence of a declared PSTN OA service, would competition in downstream retail markets for relevant services be effective?
- In the absence of access to a declared PSTN OA in the CBD and metropolitan exemption areas, would such firms provide a meaningful constraint on the pricing of the PSTN OA or equivalent services?
- Would Telstra be likely to continue to supply the PSTN OA in the absence of declaration?

The ACCC is interested in views on whether the PSTN OA is a replicable service:

- Are PSTN voice services replicable through the use of:
 - DSLAMs?
 - traditional voice switching equipment?
 - soft switches?
 - alternative infrastructure such as fixed wireless or HFC cable networks?
- Are Telstra's statements about the competitiveness of VoIP and mobile services

accurate? Are these services an effective substitute to PSTN services?

Finally, the ACCC is interested in views on technical and economic issues related to DSLAM deployment.

- Is there any significant difference in competitive conditions between an ESA with one competitive DSLAM and an ESA with two or more competitive DSLAMs?
- To appropriately gauge competitive conditions in an ESA, does the ACCC need information on the number of ULLS and LSS lines and how this has changed over time?
- What are the key drivers of DSLAM-based deployment?
- What scale is required in an ESA to justify DSLAM-based deployment?
- What is the nature and extent of costs associated with DSLAM-based deployment?
- If an access seeker has a DSLAM in an exchange, does that mean it is technically capable of providing a voice service to end-users? If so, would the upgrade costs to enable the provision of PSTN voice services be significant?
- What are the technical and cost differences in DSLAMs that can be used to provide voice and those that can only be used to provide xDSL (i.e. ULLS-based DSLAMs vs LSS-based DSLAMs)?
- What percentage of DSLAMs currently deployed would be capable of providing PSTN voice services?
- Are there any other physical or technical constraints associated with deploying a DSLAM in an exchange?

Potential for competition

While there is some overlap with the issues identified above in the discussion of structural factors, the ACCC considers that it is also important that it have regard to the potential for effective competition to develop. The ACCC identified three factors to be considered in the second position paper in its *Fixed Services Review* — planned entry, the size of the addressable market and the existence of barriers to entry or expansion.

Telstra submits that, in the CBD exemption area, based on actual and planned infrastructure deployment, all ESAs will shortly have six DSLAMs in the exchange.⁶⁶ Telstra also submits that, in the metropolitan exemption area, based on actual and planned infrastructure deployment, nearly 90 per cent of ESAs will have two or more DSLAMs in the exchange and 72 per cent of ESAs will have three or more DSLAMs by the end of 2007.⁶⁷

⁶⁶ Ibid, Annexure A, p. 23.

⁶⁷ Ibid, Annexure A, p. 28.

In this regard, the ACCC has previously noted that it is necessary to view prospective investment plans somewhat cautiously given the potential for exogenous factors to alter the likelihood of actual investment.⁶⁸

The ACCC also noted in its second position paper that the size of the addressable market is arguably one of the most important factors in determining whether effective competition is likely to be viable.⁶⁹ The size of the addressable market is closely linked to measures of population density or household density (or, more strictly, teledensity) within an ESA, with higher densities likely to lead to better prospects for infrastructure deployment and effective competition. For example, the CBD areas of Sydney, Melbourne, Adelaide, Perth and Brisbane, which comprise the CBD exemption area, are characterised by high population densities.⁷⁰

All ESAs in Telstra's proposed metropolitan exemption area are located in Band 2. This implies that all of the ESAs meet a certain minimum teledensity – that is, Telstra's Bands are defined by reference to the number of SIOs per square kilometre. However, the ACCC notes that the teledensity within a Band can vary quite significantly.⁷¹

On this point, Telstra states that only a relatively small number of services are necessary in an ESA for an access seeker to recover its costs. It contends that the minimum number of customers needed for profitability by an access seeker using the ULLS to provide voice and data services in Band 2 is less than [c-i-c] SIOs.⁷² If correct, these figures would suggest that issues of teledensity are not significant.

The ACCC's second position paper stated that, to be a relevant consideration, barriers to entry, expansion and exit simply need to represent an impediment for rivals which places rivals at a disadvantage.⁷³ The ACCC noted that barriers to entry and expansion can occur for a variety of reasons, such as technical supply-side constraints, sunk costs, economies of scale and scope, legal and regulatory barriers, product differentiation and brand loyalty, customer fixed-term contracts, the threat of retaliatory action and non-price factors.⁷⁴

In its submission, Telstra makes a number of contentions that demonstrate that there are no material barriers to DSLAM-based entry or expansion.⁷⁵

⁶⁸ ACCC, *Fixed services review—a second position paper*, April 2007, p. 44.

⁶⁹ *Ibid.*, p. 44.

⁷⁰ Australian Bureau of Statistics, *Regional population growth, Australia, 1996 to 2006*, Catalogue 3218.0, released 24 July 2007.

⁷¹ The ACCC has published a comparison of the population density of selected metropolitan regions: ACCC, *Fixed services review—a second position paper*, April 2007, p. 45.

⁷² Telstra, *Telstra's PSTN OA Service Exemption Applications—Supporting submission*, October 2007, Annexure A, p. 38.

⁷³ ACCC, *Fixed services review—a second position paper*, April 2007, p. 46.

⁷⁴ *Ibid.* p. 47.

⁷⁵ Telstra, *Telstra's PSTN OA Service Exemption Application—Supporting submission*, October 2007, p. 31.

Questions for interested parties:

The ACCC seeks comment from interested parties on a number of issues relevant to **potential for competition** and, in particular, information from parties on the nature and extent of planned investments. The ACCC would like interested parties to answer these questions separately for the CBD exemption area and the metropolitan exemption area.

The ACCC is interested in the current planned infrastructure deployment in the proposed exemption areas.

- Are these planned investments representative of the likely deployment of DSLAMs in the proposed exemption area by the end of 2007? How cautiously should the ACCC regard these planned deployments?
- Would new DSLAMs all have the capacity to provide voice services, or would some of the DSLAMs only be capable of providing DSL broadband?

The ACCC is also interested in views on the size of the addressable market.

- Is the size of the addressable market in the CBD exemption area and in the metropolitan exemption area, respectively, large enough to allow access seekers to achieve sufficient economies of scale or density to provide effective competition?
- Are Telstra's estimates of the minimum efficient scale for DSLAM entry robust? Does an access seeker only need to have an amount less than [c-i-c] SIOs for DSLAM-based entry to be viable?

The ACCC seeks information about the nature and extent of barriers to entry.

- Are Telstra's assertions that there are no material barriers to entry associated with deploying DSLAM-based infrastructure accurate?
- Would access seekers using DSLAMs and the ULLS, or providing VoIP services, be able to provide voice services of equivalent quality to Telstra's voice services?
- What non-price barriers to entry exist for the use of DSLAMs to provide PSTN services?
- What, if any, barriers to entry, expansion and exit exist in relation to DSLAM-based infrastructure?

Dynamic characteristics of markets

The ACCC has noted that the structural features of relevant markets may change over time.⁷⁶ This can be due to factors such as market growth, technological development and the convergence of products and markets, and/or changes in prices and costs over time.

⁷⁶ ACCC, *Fixed services review—a second position paper*, April 2007, p. 47.

The timeframe for dynamic changes to market characteristics is an important consideration. In this regard, Telstra is seeking exemption from the SAOs until the earlier of:

- the PSTN OA ceasing to be an active declared service
- a court finding that Part XIC of the TPA does not apply to the ULLS or LSS
- 30 December 2012.

Questions for interested parties:

The ACCC seeks information on the dynamic characteristics of the relevant markets.

- If the ACCC grants the exemption applications, for what period should the ACCC grant the exemptions?
 - Should the exemptions be granted until 2012, as sought by Telstra, or until the current expiry date of the PSTN OA service?
- If the ACCC grants the exemption applications, should the exemptions take effect immediately, or should it be deferred?

Nature and extent of vertical integration

Telstra is a vertically integrated carrier, supplying at all levels of the supply chain. The ACCC has noted that vertical integration raises issues of price and non-price constraints on the ability of new entrants to compete effectively in specific downstream market segments.⁷⁷

Question for interested parties:

- Are there any other issues relating to vertical integration relevant to the exemption applications that have not been raised above?

Other issues

There may be other issues that the ACCC could take account of in deciding whether to grant the exemptions. One issue is that it may be appropriate to place certain conditions on the granting of the exemption applications. For example, in granting Telstra's exemption application for the LCS in CBD areas, the ACCC granted the exemption to apply one year from the making of the exemption order and subject to Telstra providing written notice of certain events relating to the sale of the LCS.⁷⁸

Question for interested parties:

- What conditions (if any) should be placed on the granting of the exemption

⁷⁷ Ibid, p. 48.

⁷⁸ ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002, pp. 66-9.

applications for the PSTN OA?

5.3 *Any-to-any connectivity*

In its July 2006 Declaration Inquiry, the ACCC considered that the declaration of the PSTN OA would not impact on the objective of any-to-any connectivity.⁷⁹

Telstra submits in support of its exemption applications that the exemptions would not have a bearing on any-to-any connectivity.

Questions for interested parties:

- Would granting the exemption applications have any effect on any-to-any connectivity?

5.4 *Efficient use of and investment in infrastructure*

When assessing whether an exemption will be in the LTIE, the ACCC is required to consider whether exemption would be likely to encourage the:

- economically efficient use of infrastructure
- economically efficient investment in:
 - infrastructure by which listed services are supplied
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.

There is a strong relationship between the relevant factors when considering the promotion of competition and the relevant factors when considering the encouragement of economically efficient use of and investment in infrastructure. The ACCC's view on the likely effect of granting the exemption applications on competition will influence its view on the likely effect of granting the exemption applications on economic efficiency. As noted above, the ACCC considers that the effect of the exemptions on the incentives for investment is likely to be a significant factor in deciding whether to grant the applications.

Competition is generally only promoted by declaration of a service where there is market power in the upstream market. In other words, market power enables a firm to charge prices that differ from the efficient cost based price, leading to inefficient use of infrastructure. However, if a market for a wholesale service is effectively competitive, then prices should approach underlying costs and the declaration of a service is unlikely to promote the economically efficient use of and investment in infrastructure. Instead, there may be costs associated with regulation that actually discourage economically efficient use of and investment in infrastructure.

⁷⁹ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final Determination*, July 2006. p. 35.

Telstra submits that the granting of the exemptions would promote the economically efficient use of, and investment in, infrastructure. Telstra suggests that PSTN OA regulation is leading to inefficient use of infrastructure and creating obstacles to the form of competition that is most likely to promote the LTIE – that is, facilities-based competition.

Questions for interested parties:

- Would granting the exemption applications have any effect on the efficient use of infrastructure by which listed services are provided?
- What impact would granting the exemptions have on the efficient use of infrastructure in upstream products such as the ULLS?
- Would granting the exemptions significantly affect Telstra’s incentives to invest in its infrastructure?
- Would granting the exemptions affect Telstra’s plans to invest in maintenance, improvement and expansion of its fixed network infrastructure?
- How realistic are the costs of regulation identified by Telstra? Are regulators likely to set access prices too low and are the impacts of doing so asymmetric?
- Has declaration of the PSTN OA discouraged investment in alternative voice infrastructure by access seekers?
- Would granting the exemption applications be likely to encourage efficient investment in alternative infrastructure by removing the scope for reliance on the declared PSTN OA?
- What implications would Telstra’s exemption applications, and proposed rule for including ESAs in its exemption area, have on investment by access seekers in DSLAM infrastructure? Would an alternative rule be preferable?

Technical feasibility

The TPA provides that, in considering an exemption application, regard must be had to whether it is or is likely to become, technically feasible for services to be supplied and charged for.⁸⁰

It is technically feasible for Telstra to continue to supply the service regardless of whether or not the exemptions were granted. The ACCC considers that issues of the technical feasibility of providing equivalent services by other carriers are adequately dealt with above.

Legitimate commercial interests of access provider

The TPA provides that, in considering an exemption application, regard must be had to the legitimate commercial interests of the access provider of a service, including the ability to exploit economies of scale and scope.⁸¹

⁸⁰ TPA paragraph 152AB(6)(a).

The legitimate commercial interests of an access provider primarily consists of being able to recover its efficient costs of providing services, including earning a reasonable return on its assets, but also includes its interests in meeting contractual commitments and in using its network for future requirements.

The ACCC considers that the main issue is whether granting the exemption applications will mean that Telstra could set prices at an inefficiently high level to generate monopoly profits at the expense of competition and the LTIE.

As Telstra has submitted the exemption applications, this suggests that granting the exemptions would be unlikely to be against Telstra's legitimate commercial interests. Telstra submits that its legitimate commercial interests would be enhanced by granting the exemptions as it will have greater commercial freedom and flexibility.⁸²

Questions for interested parties:

- Would granting the exemption applications be likely to allow Telstra to recover more than is in its legitimate commercial interests?

5.5 Class exemption

In addition to granting individual exemptions from SAOs under section 152AT of the TPA, the ACCC is also able to grant exemptions to a class of carriers under section 152AS of the TPA.

In its consideration of Telstra's last application for an exemption from SAOs for the LCS in CBD areas, the ACCC also considered whether it would be appropriate to grant a class exemption.⁸³ The ACCC ultimately also made a class exemption in addition to granting Telstra's individual exemption.⁸⁴

Under subsection 152AS(5) of the TPA, before making a class exemption, the ACCC must publish a draft of the exemption determination and invite submissions where the ACCC is of the view that the granting of the exemption is likely to have a material effect on the interests of a person. At the present time, the ACCC is seeking views on whether a class exemption should be made on terms similar to those expressed in Telstra's individual exemption applications. If the ACCC reaches a view that a class exemption should be made, it will publish a draft determination at the time of making its draft decision on Telstra's exemption applications.

⁸¹ TPA paragraph 152AB(6)(b).

⁸² Telstra, *Telstra's PSTN OA Service Exemption Applications—Supporting submission*, October 2007, p. 62.

⁸³ ACCC, *Future scope of the local carriage service declaration—discussion paper*, August 2000, p. 6.

⁸⁴ ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002, pp. 64–65.

Questions for interested parties:

- Should the ACCC make a class exemption in similar terms to Telstra's individual exemption applications?
 - What would an appropriate class of carrier be?
- Are there any considerations for granting a class exemption that differ from those for Telstra's individual exemption applications?
- Should the conditions (if any) for a class exemption be different from those for the individual exemptions (if any)?

Appendix A: Legislative background

Part XIC of the TPA sets out a telecommunications access regime. This section of the discussion paper outlines the provisions of the access regime relevant to the exemption applications.

A.1 Declaration and the SAOs

The ACCC may determine that particular carriage services and related services are declared services under section 152AL of the TPA. A carrier or carriage service provider that provides a declared service to itself or other persons is known as an access provider. Once a service is declared, access providers are subject to a number of SAOs pursuant to section 152AR of the TPA. Terms of access can be governed by the terms of an undertaking or, in the absence of an accepted undertaking, by ACCC determination in an access dispute.

In summary, the SAOs require that an access provider, if requested by a service provider, must:

- supply the declared service
- take all reasonable steps to ensure that the technical and operational quality of the service supplied to the service provider is equivalent to that which the access provider is supplying to itself
- take all reasonable steps to ensure that the fault detection, handling and rectification which the service provider receives in relation to the declared service is of equivalent technical and operational quality as that provided by the access provider to itself
- permit interconnection of its facilities with the facilities of the service provider
- take all reasonable steps to ensure that the technical operational quality and timing of the interconnection is equivalent to that which the access provider provides to itself
- take all reasonable steps to ensure that the service provider receives interconnection fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself
- if a standard is in force under section 384 of the *Telecommunications Act 1997*, take all reasonable steps to ensure that the interconnection complies with the standard
- if requested by the service provider, provide billing information in connection with matters, or incidental to, the supply of the declared services

- if an access provider supplies an active declared service by means of conditional-access customer equipment, the access provider must, if requested to do so by a service provider supply any service that is necessary to enable the service provider to supply carriage services and/or content services by means of the declared service and using the equipment.

The ACCC must only declare a service if, following a public inquiry, it considers that declaration would promote the LTIE. Section 152AB of the TPA states that, in determining whether declaration promotes the LTIE, regard must be had only to the extent to which declaration is likely to result in the achievement of the following objectives:

- promoting competition in markets for listed services
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which telecommunications services are supplied or are, or are likely to become, capable of being supplied.

Section 152AB also provides guidance in interpreting these objectives. The three objectives are discussed further below.

A.2 Exemptions from SAOs

Exemptions can be granted from the SAOs. This can occur in two ways:

- a class exemption under section 152AS of the TPA
- an individual exemption under section 152AT of the TPA.

In the case of an individual exemption application, a carrier or carriage service provider may apply to the ACCC for a written order exempting it from any or all of the SAOs that apply to a declared service.⁸⁵

If the ACCC is of the opinion that the making of an exemption order would be likely to have a material effect on the interests of a person, the ACCC must publish the application for an exemption and invite submissions from the public.⁸⁶ The ACCC must consider any submissions received within the time specified.

The ACCC must not grant an exemption order unless the ACCC is satisfied that the making of the order will promote the LTIE.⁸⁷ An exemption order can be unconditional or subject to such conditions or limitations as are specified in the order.⁸⁸

⁸⁵ TPA subsection 152AT(1).

⁸⁶ TPA subsection 152AT(9).

⁸⁷ TPA subsection 152AT(4).

⁸⁸ TPA subsection 152AT(5).

The ACCC has a six month period in which to make the decision to accept or reject the exemption order.⁸⁹ However the six month period does not include any period where the ACCC has published the application and invited people to make submissions within a specific time limit, or where there is an outstanding response to an information request.⁹⁰ The ACCC may also extend the six month period by a further three months in certain circumstances.⁹¹

After considering the application, the ACCC must either make a written exemption order or refuse the application.⁹²

A class exemption under section 152AS of the TPA similarly can only be made if the ACCC believes that the exemption will be in the LTIE. However the exemption applies to a specified class of carrier or carriage service provider, and there is no six month time limit on consideration of a class exemption.

A.3 Long-term interests of end-users

Both a decision to declare a service and a decision to grant an exemption from the SAOs for a declared service—the latter being the matter currently under consideration—can only be made if the ACCC considers that making the declaration or granting the exemption will be likely to promote the LTIE.

As noted above, section 152AB of the TPA states that, in determining whether declaration promotes the LTIE, regard must be had only to the extent to which the exemption is likely to result in the achievement of the following objectives:

- promoting competition in markets for listed services
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which telecommunications services are supplied or are, or are likely to become, capable of being supplied.

The objectives are interrelated. In many cases, the LTIE may be promoted through the achievement of two or all of these matters simultaneously. In other cases, the achievement of one of these matters may involve some trade-off in terms of another of the matters, and the ACCC will need to weigh up the different effects to determine whether the exemption promotes the LTIE. In this regard, the ACCC will interpret long-term to mean the period of time necessary for the substantive effects of the exemption to unfold.

The following discussion provides an overview of what the ACCC must consider in assessing each of these objectives.

⁸⁹ TPA subsection 152AT(10).

⁹⁰ TPA subsection 152AT(11).

⁹¹ TPA subsection 152AT(12).

⁹² TPA subsection 152AT(3).

Promotion of competition

Subsections 152AB(4) and (5) of the TPA provide that, in interpreting this objective, regard must be had to, but is not limited to, the extent to which the arrangements will remove obstacles to end-users gaining access to listed services. The Explanatory Memorandum to Part XIC of the TPA states that:⁹³

...it is intended that particular regard be had to the extent to which the...[declaration]... would enable end-users to gain access to an increased range or choice of services.

This requires the ACCC to make an assessment of whether or not the exemption would be likely to promote competition in the markets for listed services.

The concept of competition is of fundamental importance to the TPA and has been discussed many times in connection with the operation of Part IIIA, Part IV, Part XIB and Part XIC of the TPA.

In general terms, competition is the process of rivalry between firms, where each market participant is constrained in its price and output decisions by the activity of other market participants. The Trade Practices Tribunal (now the Australian Competition Tribunal) stated that:⁹⁴

In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.

Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate.

Competition can provide benefits to end-users including lower prices, better quality and a better range of services over time. Competition may be inhibited where the structure of the market gives rise to market power. Market power is the ability of a firm or firms profitably to constrain or manipulate the supply of products from the levels and quality that would be observed in a competitive market for a significant period of time.

The establishment of a right for third parties to negotiate access to certain services on reasonable terms and conditions can operate to constrain the use of market power that could be derived from the control of these services. Accordingly, an access regime such as Part IIIA or Part XIC addresses the structure of a market, to limit or reduce the sources of market power and consequent anti-competitive conduct, rather than directly regulating conduct which may flow from its use, which is the role of Part IV and Part XIB of the TPA. Nonetheless, in any given challenge to competition, both Parts XIB (or IV) and XIC may be necessary to address anti-competitive behaviour.

To assist in determining the impact of potential exemption on downstream markets, the ACCC will first need to identify the relevant market(s) and assess the likely effect of exemption on competition in each market.

⁹³ Trade Practices Amendment (Telecommunications) Act 1997 (Cth) Explanatory memorandum.

⁹⁴ *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd*, (1976) ATPR 40-012, 17,245.

Section 4E of the TPA provides that the term ‘market’ includes a market for the goods or services under consideration and any other goods or services that are substitutable for, or otherwise competitive with, those goods or services. The ACCC’s approach to market definition is discussed in its *Merger Guidelines*, June 1999 and is also canvassed in its second position paper, *Strategic Review of Fixed Services*, April 2007.

The second step is to assess the likely effect of the exemption on competition in each relevant market. As noted above, subsection 152AB(4) requires that regard must be had to the extent to which a particular thing will remove obstacles to end-users gaining access to listed services.

The ACCC considers that denial to service providers of access to necessary upstream services on reasonable terms is a significant obstacle to end users gaining access to services. In this regard, declaration can remove such obstacles by facilitating entry by service providers, thereby providing end users with additional services from which to choose. For example, access to a mobile termination service may enable more service providers to provide fixed to mobile calls to end-users. This gives end-users more choice of service providers.

Where existing market conditions already provide for the competitive supply of services, the access regime should not impose regulated access and therefore, granting an exemption would generally be appropriate in such circumstances. This recognises the costs of providing access, such as administration and compliance, as well as potential disincentives to investment. Regulation will only be desirable where it leads to benefits in terms of lower prices, better services or improved service quality for end-users that outweigh any costs of regulation.

In the context of considering whether an exemption will promote competition, it is therefore appropriate to examine the impact of the existing declaration on each relevant market, the likely effect of reduced access obligations on the relevant market, and compare the state of competition in that market with and without the exemption. In examining the market structure, the ACCC considers that competition is promoted when market structures are altered such that the exercise of market power becomes more difficult; for example, because barriers to entry have been lowered (permitting more efficient competitors to enter a market and thereby constrain the pricing behaviour of the incumbents) or because the ability of firms to raise rivals’ costs is restricted.

Any-to-any connectivity

Subsection 152AB(8) of the TPA provides that the objective of any-to-any connectivity is achieved if, and only if, each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, or a similar service, with other end-users whether or not they are connected to the same network. The reference to ‘similar’ services in the TPA enables this objective to apply to services with analogous, but not identical, functional characteristics, such as fixed and mobile voice telephony services or Internet services which may have differing characteristics.

The any-to-any connectivity requirement is particularly relevant when considering services that involve communications between end-users. When considering other types of services (such as carriage services that are inputs to an end-to-end service or distribution services such as the carriage of pay television), the ACCC generally considers that this criterion will be given less weight compared to the other two criteria.

Efficient use of, and investment in, infrastructure

Subsections 152AB(6) and (7A) of the TPA provide that, in interpreting this objective, regard must be had to, but is not limited to, the following:

- whether it is technically feasible for the services to be supplied and charged for, having regard to:
 - the technology that is in use or available
 - whether the costs that would be involved in supplying, and charging for, the services are reasonable
 - the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the service, including the ability of the supplier or suppliers to exploit economies of scale and scope
- the incentives for investment in:
 - the infrastructure by which the services are supplied and
 - any other infrastructure by which the services are, or are likely to become, capable of being supplied.

In determining the extent to which a particular aspect is likely to encourage the efficient investment in other infrastructure, the ACCC must have regard to the risks involved in making the investment.

Economic efficiency has three components.

- Productive efficiency refers to the efficient use of resources within each firm such that all goods and services are produced using the least cost combination of inputs.
- Allocative efficiency refers to the efficient allocation of resources across the economy such that the goods and services that are produced in the economy are the ones most valued by consumers. It also refers to the distribution of production costs amongst firms within an industry to minimise industry-wide costs.

- Dynamic efficiency refers to the efficient deployment of resources between present and future uses such that the welfare of society is maximised over time. Dynamic efficiency incorporates efficiencies flowing from innovation leading to the development of new services, or improvements in production techniques.

The ACCC will need to ensure that the access regime does not discourage investment in networks or network elements where such investment is efficient. The access regime also plays an important role in ensuring that existing infrastructure is used efficiently where it is inefficient to duplicate investment in existing networks or network elements.

The technical feasibility of supplying and charging for particular services

This incorporates a number of elements, including the technology that is in use or available, the costs of supplying, and charging for, the services and the effects on the operation of telecommunications networks.

In many cases, the technical feasibility of supplying and charging for particular services given the current state of technology may be clear, particularly where (as in the present case) the service is already declared and there is a history of providing access. The question may be more difficult where there is no prior access, or where conditions have changed. Experience in other jurisdictions, taking account of relevant differences in technology or network configuration, will be helpful. Generally the ACCC will look to an access provider to demonstrate that supply is not technically feasible.

The legitimate commercial interests of the supplier or suppliers, including the ability of the supplier to exploit economies of scale and scope

A supplier's legitimate commercial interests encompass its obligations to the owners of the firm, including the need to recover the cost of providing services and to earn a normal commercial return on the investment in infrastructure. The ACCC considers that allowing for a normal commercial return on investment will provide an appropriate incentive for the access provider to maintain, improve and invest in the efficient provision of the service.

A significant issue relates to whether or not capacity should be made available to an access seeker. Where there is spare capacity within the network, not assigned to current or planned services, allocative efficiency would be promoted by obliging the owner to release capacity for competitors.

Paragraph 152AB(6)(b) of the TPA also requires the ACCC to have regard to whether the access arrangement may affect the owner's ability to realise economies of scale or scope. Economies of scale arise from a production process in which the average (or per unit) cost of production decreases as the firm's output increases. Economies of scope arise from a production process in which it is less costly in total for one firm to produce two (or more) products than it is for two (or more) firms to each separately produce each of the products.

Potential effects from access on economies of scope are likely to be greater than on economies of scale. A limit in the capacity available to the owner may constrain the number of services that the owner is able to provide using the infrastructure and thus prevent the realisation of economies of scope associated with the production of multiple services. In contrast, economies of scale may simply result from the use of the capacity of the network and be able to be realised regardless of whether that capacity is being used by the owner or by other carriers and service providers. Nonetheless, the ACCC will assess the effects of the supplier's ability to exploit both economies of scale and scope on a case-by-case basis.

The impact on incentives for investment in infrastructure

Firms should have the incentive to invest efficiently in infrastructure. Various aspects of efficiency have been discussed already. It is also important to note that while access regulation may have the potential to diminish incentives for some businesses to invest in infrastructure, it may also ensure that investment is efficient and reduces the barriers to entry for other (competing) businesses or the barriers to expansion by competing businesses.

There is also a need to consider the effects of any expected disincentive to investment from anticipated increases in competition to determine the overall effect of granting an exemption on the LTIE. The ACCC is careful to ensure that services are not declared where there is a risk that incentives to invest may be dampened, such that there is little subsequent benefit to end users from the access arrangements.

Appendix B: Telstra's confidentiality undertaking

This Telstra confidentiality undertaking will also be made available on the ACCC's website in Microsoft Word format.

COMMONWEALTH OF AUSTRALIA

Trade Practices Act 1974

IN THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION

OCTOBER 2007 EXEMPTION APPLICATIONS IN RESPECT OF THE DECLARED DOMESTIC PSTN ORIGINATING ACCESS SERVICE

CONFIDENTIALITY UNDERTAKING

I, _____ of _____, undertake to Telstra Corporation Limited ("**Telstra**") that:

- 1 Subject to the terms of this Undertaking, I will keep confidential at all times the information listed in Attachment 1 to this Undertaking ("**Confidential Information**") that is in my possession, custody, power or control.
- 2 I acknowledge that:
 - (a) this Undertaking is given by me to Telstra in consideration for Telstra making the Confidential Information available to me for the Approved Purposes (as defined below);
 - (b) all intellectual property in or to any part of the Confidential Information is and will remain owned by Telstra; and
 - (c) by reason of this Undertaking, no licence or right is granted to me, or any other employee, agent or representative of [**insert**] in relation to the Confidential Information except as expressly provided in this Undertaking.
- 3 I will:
 - (a) only use the Confidential Information for:
 - (i) the purposes of the consultation process(es) of the Australian Competition and Consumer Commission ("**ACCC**") in relation to

Telstra's October 2007 exemption applications in respect of the Domestic PSTN Originating Access Service ("**Exemptions**");

(ii) the purposes of any application made to the Australian Competition Tribunal (the "**Tribunal**") for a review of a decision made by the ACCC in respect of the Exemptions; or

(iii) any other purpose approved by Telstra in writing;

("the **Approved Purposes**");

(b) comply with any reasonable request or direction from Telstra regarding the Confidential Information.

4 Subject to paragraph 5 below, I will not disclose any of the Confidential Information to any other person without the prior written consent of Telstra.

5 I acknowledge that I may disclose the Confidential Information to which I have access:

(a) to ACCC employees for the Approved Purposes; and

(b) to any external legal advisors, independent experts, internal legal or regulatory staff of **[insert]**, for the Approved Purposes provided that:

(i) the person to whom disclosure is proposed to be made ("**the person**") is notified in writing to Telstra and Telstra has approved the person as a person who may receive the Confidential Information, which approval shall not be unreasonably withheld;

(ii) the person has signed a confidentiality undertaking in the form of this Undertaking or in a form otherwise acceptable to Telstra; and

(iii) a signed undertaking of the person has already been served on Telstra; and

(c) if required to do so by law; and

(d) to any secretarial, administrative and support staff, who perform purely administrative tasks, and who assist me or any person referred to in paragraph 5(b) for the Approved Purpose.

6 I will establish and maintain security measures to safeguard the Confidential Information that is in my possession from unauthorised access, use, copying, reproduction or disclosure and use the same degree of care as a prudent person in my position would use to protect that person's confidential information.

7 Except as required by law and subject to paragraph 11 below, within a reasonable time after whichever of the following first occurs:

- (a) the ACCC (or if appealed to the Tribunal, the Tribunal) makes a decision in relation to the Exemptions;
- (b) my ceasing to be employed or retained by **[insert]** (provided that I continue to have access to the Confidential Information at that time); or
- (c) my ceasing to be working for **[insert]** in respect of the Approved Purposes (other than as a result of ceasing to be employed by **[insert]**),

I will destroy or deliver to Telstra the Confidential Information and any documents or things (or parts of documents or things), constituting, recording or containing any of the Confidential Information in my possession, custody, power or control.

8 Nothing in this Undertaking shall impose an obligation upon me in respect of information:

- (a) which is in the public domain; or
- (b) which has been obtained by me otherwise than in relation to the Exemptions;

provided that the information is in the public domain and/or has been obtained by me in circumstances which do not involve any breach of a confidentiality undertaking or a breach of any other obligation of confidence in favour of Telstra or by any other unlawful means, of which I am aware.

- 9 I acknowledge that damages may not be a sufficient remedy for any breach of this Undertaking and that Telstra may be entitled to specific performance or injunctive relief (as appropriate) as a remedy for any breach or threatened breach of this Undertaking, in addition to any other remedies available to Telstra at law or in equity.
- 10 The obligations of confidentiality imposed by this Undertaking survive the destruction or delivery to Telstra of the Confidential Information pursuant to paragraph 7 above.
- 11 I acknowledge that this Undertaking is governed by the law in force in the State of New South Wales and I agree to submit to the non-exclusive jurisdiction of the court of that place.

Signed: _____ Dated: _____

Print name: _____

ATTACHMENT 1

Any document, or information in any document provided by Telstra to **[insert]** which Telstra asserts is confidential information for the purposes of this Undertaking or is otherwise marked as confidential, including, but not limited to, the confidential version of the supporting submission (including all attachments) to the Exemptions.