

31 October 2011

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ELECTRONIC LODGEMENT

Dear Sir or Madam

Telstra's Structural Separation Undertaking Update

Telstra lodged its Structural Separation Undertaking (SSU) with the Australian Competition and Consumer Commission (ACCC) on 29 July 2011. Telstra continues to have ongoing and constructive discussions with the ACCC regarding the SSU. Telstra has also hosted information sessions with wholesale customers on the SSU.

Further to these discussions, the ACCC plans to hold an industry forum on 4 November as part of its consultation process. To help inform that discussion, Telstra is providing the **attached paper**, which describes some possible approaches to address concerns raised by the ACCC and industry on the SSU.

The possible approaches discussed in this paper are subject to further consideration and do not reflect any settled position or proposal by Telstra in relation to whether, or how, the SSU may be revised.

Telstra will continue to work closely with the ACCC on the SSU and Draft Migration Plan and aims to lodge a revised SSU with the ACCC as soon as possible. Telstra continues to believe that none of the issues raised by the ACCC in relation to the SSU is insurmountable and that they can be resolved in a way consistent with our principle of protecting shareholder value.

As Telstra has previously stated, most recently at its Annual General Meeting on 18 October 2011, if the outcome of negotiations with the ACCC in relation to the SSU were to result in any material change to the NBN Proposed Transaction as described in the Explanatory Memorandum, Telstra would ensure that shareholders have an opportunity to consider and vote on it.

Yours faithfully,



Carmel Mulhern
Company Secretary

TELSTRA CORPORATION LIMITED

Telstra discussion paper in relation to its draft Structural Separation Undertaking

31 October 2011

For discussion purposes only. This paper is for the purpose of informing continuing discussions between the ACCC, Telstra and industry stakeholders. The possible approaches discussed in this paper are subject to further consideration and do not reflect any settled position or proposal by Telstra in relation to whether, or how, the SSU may be revised. This discussion paper does not purport to have addressed all current or future issues raised in response to the SSU.

The form of any revised SSU, if submitted by Telstra, is subject to the outcome of ongoing discussions with the ACCC, any new or other issues and Telstra internal approvals.

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Introduction

Telstra lodged its Structural Separation Undertaking (**SSU**) with the Australian Competition and Consumer Commission (**ACCC**) on 29 July 2011. Since then, Telstra has been involved in ongoing and constructive discussions with the ACCC regarding the commitments and terms in the SSU. Telstra has also hosted information sessions with wholesale customers on the SSU.

This paper describes at a high level some possible approaches to address concerns raised by the ACCC and industry stakeholders on the topics set out below. It is intended to inform discussion at an industry forum to be held by the ACCC as part of its SSU consultation process. It is also intended to facilitate discussion which will inform the further development of any revised SSU.

Telstra believes that focusing on solutions to the issues discussed in this paper will enable it to put in place a set of effective measures for regulating the supply of regulated services during the transition to the NBN. Outside the SSU, the ACCC will continue to have its powers under Parts XIB and XIC, subject to the requirement not to exercise those powers in a way which prevents Telstra complying with the SSU.

Telstra will continue to work closely with the ACCC on the SSU and Draft Migration Plan and aims to lodge a revised SSU with the ACCC as soon as possible. Telstra continues to believe that none of the issues raised by the ACCC in relation to the SSU is insurmountable and that they can be resolved in a way consistent with our principle of protecting shareholder value.

A **Overarching commitment to equivalence**

The ACCC has indicated it would likely reject the SSU if it did not include an overarching commitment to equivalence by Telstra¹.

The ACCC believes an overarching equivalence obligation is more likely to ensure 'cultural change' within Telstra than a set of specific obligations alone might achieve, and provide a means of ensuring that the interim equivalence and transparency measures remain 'fit for purpose'. Industry has supported the ACCC's view.

Telstra is considering options to respond to this issue which balance the ACCC position with Telstra's desire to ensure such an obligation would provide it with the certainty needed to manage compliance in its daily operations.

An option being considered by Telstra involves the following:

1. The SSU would include an overarching commitment to equivalence that can be directly enforced by the ACCC. This test would measure equivalence in respect of: (1) technical and operational quality; (2) operational systems, procedures and processes; (3) information about (1) and (2); and (4) price equivalence (as defined by the commitments on TEM reporting and wholesale DSL).
2. This commitment would apply as necessary to ensure wholesale customers are not materially disadvantaged in their ability to compete in any market with the price and non-price terms and conditions offered by Telstra in that market.
3. The ACCC has emphasised the importance of providing incentives for 'cultural change': One way of encouraging Telstra to monitor compliance, self-report and proactively bring forward 'fixes' to any failure to comply with this standard, would be to create a 'two track' reporting and enforcement mechanism. Under this model:
 - where Telstra self-reports it is given the first opportunity to propose a 'fix' and the possibility of damages or pecuniary remedies is ruled out; and
 - alternatively, where the ACCC notifies a possible breach, unless Telstra disputes that a breach has occurred (in which case the ACCC would be entitled to enforce through the Federal Court), Telstra is given the first opportunity to propose a 'fix' but in this stream the ACCC may still seek compensation and pecuniary remedies in the Federal Court.

¹ See section 10.3.1 of the ACCC discussion paper.

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4. In either case, the ACCC would be able to direct alternative fixes in the event it did not consider Telstra's proposed fix to be fit for purpose.
 5. Telstra would be bound to implement an alternative fix directed by the ACCC, unless it sought a judicial review within 28 days, in which case Telstra must implement its proposed fix pending the outcome of the review.
 6. As the SSU dispute resolution mechanism currently provides, complaints from wholesale customers about breaches of the equivalence commitment would need to be first raised with Telstra before it can be notified by the ACCC. Telstra would be required to deal with these complaints through the proposed accelerated investigation process. This approach will provide the opportunity for a quicker resolution of wholesale customer complaints than may occur through the more formal process of an ACCC notified complaint.
 7. If Telstra's investigation of an individual wholesale customer's complaint finds a breach of the equivalence commitment, Telstra would have the incentive to self report the breach and propose a 'fix'. This both ensures the availability of the 'fix' to other wholesale customers and, through its binding directions power, ACCC oversight of the adequacy of Telstra's responses to wholesale customer complaints.
 8. Other matters to consider are the express limits which would need to be placed on the overarching commitment and the scope of any ACCC power to make directions, for example, so that it is clear:
 - the fixes Telstra is required to implement are proportionate and justified having regard to matters such as:
 - the principle that the benefits of the fix should outweigh the costs; and
 - whether the fix is the least cost solution;
 - the overarching commitment, or the ACCC's direction power, would not:
 - impose any element of functional separation (transfer pricing, self consumption of wholesale services, use of same systems and processes, direct supply of services by the network services business unit and use of separate branding for wholesale and network services business units);
 - add to or amend the overarching commitment itself or the specific commitments in the SSU regarding price equivalence and Telstra's organisational structure; or
 - increase the ITA caps;

- it is not intended Telstra be required to supply services that are not Regulated Services, or to supply a Regulated Service with any feature, functionality, application or content that is not included in the declared service description for that Regulated Service, or in the case of WDSL, to impose a requirement which extends beyond the DSL Upgrade commitment in clause 14 of the current draft of the SSU; and
 - it is not intended that Telstra be prevented from:
 - obtaining a sufficient amount of a service to be able to meet its reasonably anticipated requirements;
 - denying access on the grounds of creditworthiness or a failure to protect the integrity of networks of the safety of relevant persons; or
 - engaging in conduct in connection with matters covered by the Migration Plan.
9. Telstra would also commit to providing the ACCC with monthly reports regarding its compliance with the overarching commitment. The report would include details such as:
- details of any equivalence complaints or other issues identified in the relevant month;
 - whether Telstra consider the complaint/ issue constitutes a possible breach and, if not
 - reasons why Telstra has formed this view; and
 - details of the action that Telstra proposes to take to respond to and address the complaint / issue (if any); and
 - certification that Telstra has not identified any equivalence issues in that month which it has not disclosed in the report (and details about the steps that have been taken to verify that this is the case, which may include requesting relevant staff to confirm if they are aware of any equivalence issues).

B Organisational measures (clause 8)

The original SSU provided (in clause 8.10) that a person with management responsibilities for one of the separated business units was not required to 'work principally for' that business unit but could perform other management functions within Telstra, *provided they complied with the other measures in clause 8*. This clause was included because, as Telstra is a single entity, there will come a point in the company's organisational structure or hierarchy where senior managers have functions that involve undertaking management

responsibilities for more than one business unit or for making decisions that relate to or impact more than one business unit.

For the same reasons, clause 8.10 also provided that employees with management responsibilities for the wholesale or network services business unit would not be subject to the incentive remuneration requirements where their management responsibilities for that business unit did not comprise a substantial part of their overall responsibilities.

Concerns have been raised about the scope of the exemption provided in clause 8.10 and whether, in its current form, it could be exploited by Telstra to circumvent the application of the organisational measures it is committing to. For example, in its discussion paper the ACCC considers whether clause 8.10 would permit the same person performing management functions for both retail and wholesale business units².

Accordingly, Telstra is considering ways to amend clause 8.10 to provide further assurance about this issue. An option being considered is for Telstra to remove the current senior management exception and replace it with an express prohibition against any person that has line management responsibility for a retail business unit from performing line management responsibilities for a wholesale business unit (and vice versa). The only exceptions to this prohibition and the matching incentive remuneration requirements in clause 8.6 would be for the CEO and the COO (as well as any other roles approved from time to time by the ACCC).³

This approach would require a definition of 'line management responsibilities', such as accountability for a business unit meeting its business objectives and the associated authority to make decisions about its management and operation, but a role will not have line management responsibility simply because it undertakes functions for or makes decisions relating to that business unit as part of group-wide responsibilities (for example, a person who works in the Human Resources business unit will undertake functions for or make decisions that will impact other business units but will not be considered to have 'line management responsibility' for those business units).

C Information security measures (clause 9)

In its discussion paper the ACCC raised the concern that the information security measures in clause 9 do not appear to include any commitments about the use or disclosure of nationally aggregated information where the identity of the wholesale customer is capable of being ascertained⁴.

Telstra is considering how best to address this concern. An option would be for it to expressly prohibit any retail business unit from accessing this

² See section 10.5.3, page 92, of the ACCC discussion paper.

³ It is also intended that the ACCC will have the power to approve other roles as being exempt where relevant.

⁴ See section 10.6.3, page 96, of the ACCC discussion paper.

information unless, with ACCC approval, that information is also disclosed to wholesale customers at the same time.

D Service quality and operational equivalence measures (clause 10)

Clause 10.7 of the original SSU provided that Telstra will not be in breach of the service quality and operational equivalence measures in clause 10 unless the relevant failure to comply was material and formed part of a demonstrable pattern of repeated non-compliance.

Given the potentially significant remedies that can be imposed on Telstra for breaches of the SSU⁵, this 'enforcement threshold' was intended to avoid a 'hair trigger' to enforcement where the breach involved relatively minor or isolated incidents.

Concerns have been expressed that the proposed enforcement threshold is too high. Telstra is looking at whether this requirement (i.e. to show systemic non-compliance) could be removed or modified, including potentially replacing it with a test which looks at whether the relevant failure to comply has had a material impact on wholesale customers and whether it was caused by an inadvertent act or omission.

E TEBA commitments (clause 11)

The commitments in clause 11 of the original SSU provide that Telstra may reserve exchange capacity for the purpose of supplying its own retail and wholesale services where it has bona fide documented plans to use the space within 36 months after the date of reservation. Telstra notes this is consistent with existing practice, but there is a concern it would give Telstra a competitive advantage over wholesale customers.

An option being considered by Telstra to address this concern is to allow Wholesale Customers to request a non-transferrable allocation of floor space in an exchange for up to 3 years for the purpose of meeting their future anticipated requirements, without the need to submit forecasts to Telstra or to install equipment.

Telstra considers this approach would need to be developed based on the following principles:

- Ordinary TEBA processes and practices should still be used for submitting and processing these requests (including any preliminary study reviews, fees or other standard process requirements). However, some activities, like power and air conditioning viability audits might be

⁵ See section 577G of the Telecommunications Act 1997.

left until after the wholesale customer is ready to use the reserved space.

- If there was insufficient floor space at the exchange to permit the request, the ordinary governance processes referred to in clause 11.5 of this SSU which relate to expansion or capping of the exchange will apply.
- Where sufficient floor space was available to meet the wholesale customer's request, the wholesale customer would have up to 36 months (commencing at the time of allocation) to use the allocated floor space.
- The wholesale customer would be required to pay for the allocated floor space according to ordinary rates, whether or not it is used (noting that Telstra incurs costs in reserving space for its own reasonably anticipated requirements e.g. Capex and Opex of building and maintaining exchange facilities).
- When the wholesale customer is ready to use the allocated floor space, the wholesale customer would then use ordinary TEBA processes to request preparation works so the space can be used. For example, this may include Telstra undertaking activities such as power and air conditioning viability audits.
- Where the wholesale customer has not used any part of the allocated floor space at the expiry of the 36 month period, the allocation would roll over on a month to month basis, but Telstra would be entitled to terminate the allocation at any time by giving one month's prior notice to the wholesale customer.
- The wholesale customer would be entitled to withdraw its order at any time without penalty by submitting a request to Telstra using ordinary TEBA processes.

F **Commitments about wholesale customer facing systems (clause 12)**

The original SSU provided a range of new commitments by Telstra related to the operational functionality and reliability of its wholesale business support systems (including its business to business interface and wholesale portal).

Telstra is considering whether to extend these commitments to include the 'service qualification' (SQ) systems used by Telstra for regulated copper services, except ULLS (the nature of the ULLS product means that a different SQ tool is needed for that product).

Telstra currently sees any new SQ commitment as potentially having two parts:

- **The equivalence of its current wholesale SQ systems** : so that Telstra would provide a commitment related to the overall standard of reliability and response accuracy of the wholesale SQ system which is equivalent to the SQ systems used by its retail business unit.
- **The equivalence of any new SQ system:** Telstra is currently in the process of implementing a new SQ system which will be 'NBN ready' and which Telstra expects will be implemented during the first half of 2012. This could provide an opportunity for Telstra to upgrade and consolidate Telstra's SQ systems for legacy copper services, including so that both retail and wholesale customers use the same SQ system.

G **Information equivalence measures (clause 13 and Schedule 4)**

Telstra's approach to information equivalence recognises the channels that Telstra uses to communicate with wholesale customers are, necessarily, different to those channels used to communicate with retail customers. For example, Telstra has established 'business to business' electronic systems, a dedicated wholesale customer portal and other customer management processes (such as monthly customer reviews), which are not available to retail customers.

Therefore, rather than specifying the 'same' systems should be used, the original draft of the SSU provided for information equivalence by establishing a set of minimum levels of wholesale customer engagement, as well as expanding the existing set of 'copper network notifications' that had applied under Operational Separation to also include notifications about major network upgrades and notifications to wholesale ADSL customers (which had previously not been included).

However, the ACCC raised a concern that the existing 'network notification' for major network incidents relied on contractually agreed processes in wholesale contracts – rather than specifying a standalone notification standard or process.

Telstra is therefore considering specifying in the SSU a more detailed process for how Telstra will ensure equivalence in relation to communications with wholesale customers around major network emergencies, such as mass network disruptions caused by natural disasters. An option would be for Telstra to commit to keeping in place a 'crisis management team' which will convene in the case of any major emergency with large network or service impacts (although subject to the availability of individual members, given the urgency with which meetings are often called). This team would then include a suitably senior and qualified representative of the wholesale business unit as a permanent member (currently an Executive Director level manager).

Some appropriate equivalence principles would need to be included in any such process. These could include:

- Any communications strategy developed by the crisis management team would need to include an appropriate wholesale customer communications strategy; and
- Communications to wholesale customers and retail customers in relation to the emergency or network incident would be consistent and communicated on equivalent timescales – allowing for any differences that result only from technical differences in the channels being used.

H **Equivalence and transparency metrics (clause 15 and Schedule 3)**

In response to comments made by industry stakeholders in the course of the ACCC public consultation, Telstra is considering various options for refining the current equivalence metrics and the associated rebate process.

Some of the potential changes being considered are:

A new metric for ULL Individual Cutovers

Telstra is considering whether a new metric for ULL individual cutovers could be introduced that would require Telstra to offer an appointment that is *3 working days* after a wholesale customer submits a cutover request, where the premises is in a Band 1 or Band 2 area and there is an 'Intact' metallic path at the premises.

A metallic path would be 'Intact' where it is connected to the network boundary point at a premises and, at the time Telstra receives a cutover request for that premises, the path is either being used to supply a basic telephone service (**BTS**) or ULLS or has been used to supply a BTS or ULLS and is currently vacant.

Changes to some of the conditions attaching to the Equivalence and Transparency Metrics

The application of the Equivalence and Transparency Metrics in the original SSU was made subject to a series of conditions designed to ensure the metrics provided a reliable measure of Telstra's equivalence performance, particularly given the consequences that apply for failing to meet the metrics.

Concerns have been raised about these conditions and the extent to which they provide a shield for Telstra to argue its way out of complying with the Equivalence and Transparency Metrics.⁶

Telstra is considering a number of potential changes to the conditions to respond to those concerns, including:

⁶ See section 10.7.3 of the ACCC discussion paper.

- The operational equivalence commitments in clause 10 could be extended to Telstra's fibre networks (i.e. *not* be limited to services supplied using the Copper Network)⁷;
- Removing the current exclusion in clause 15.1(e) for metrics that are subject to low or disproportionate volumes of wholesale orders;
- Modifying the exclusion in clause 11(a) of Schedule 3 for areas affected by NBN activities so that it would only exclude metrics that use an 'absolute' measure to measure Telstra's performance and do not involve comparing Telstra's wholesale performance with its retail performance;
- Removing the 'specific' conditions in clause 10 of Schedule 3 of the original SSU and provide further clarity about the circumstances in which each metric will (or will not) apply; and
- Clarifying that the 'general' conditions in clause 11 of Schedule 3 would not operate as an exclusion from the service quality and operational equivalence measures that Telstra has committed to in clause 10 of the SSU.

I **Service level rebates (clause 16 and Schedule 7)**

As explained in Telstra's submission in support of the SSU, Telstra has adopted a 'pay' and 'fix' model where the results of the equivalence and transparency metrics show equivalence is not being delivered. The service level rebate commitments in clause 16 and Schedule 7 are the 'pay' element of this model.

Concerns have been raised about the amount to be paid by Telstra under the proposed service level rebate scheme. Where service level rebates are payable, in most cases the amount Telstra is required to pay for failing to meet the applicable service level is equal to 1 x the monthly charge for the relevant service. Telstra considers these amounts are appropriate.

However, Telstra acknowledges the rebates payable for LOLO outages are in a different category because there is no corresponding monthly charge that can be used to derive the appropriate service level rebate. For LOLO outages, it is also not possible to determine the parties that have actually been affected by the outage (e.g. those that have been unable to place orders during the period of the outage) or the extent to which they've been affected.

An option which recognises this difficulty would be to calculate the service level rebate in a way that will result in all Wholesale Customers receiving a payment. However, concerns have been raised about this method because it does not take into account the duration of the outage. Telstra is considering

⁷ However, Telstra notes that these commitments will not apply to services supplied using the NBN (see clause 7.3 of the SSU).

how to address this concern, including the option of modifying the calculation of service level rebates for LOLO outages such that it increases according to the duration of the outage. This approach would need to be capped at a maximum number of hours (e.g. 100 hours for the relevant quarter).

J **Price equivalence and transparency measures (clause 17 and Schedules 8, 9, 10 and 11)**

Both the ACCC and industry stakeholders have provided feedback to Telstra on a number of aspects of its price equivalence framework, including the RMAC pricing framework proposed for Wholesale ADSL 2+ services.

Since lodging the current SSU, Telstra has also provided more detailed explanatory information to industry (and the ACCC) in relation to its proposed pricing framework and the way in which it would operate.

In light of feedback, Telstra is considering a number of options for amending the existing price equivalence and transparency measures.

Telstra is considering whether the RMAC price mechanism for Wholesale ADSL should not exclude the ACCC from later setting prices through the standard declaration process. In effect, making this change would give the ACCC the ability to oversee the operation of the RMAC mechanism and assess whether it is working appropriately. The ACCC would then retain the power to 'override' the RMAC price in the future using a declaration process, if it considered that the RMAC price was not appropriate or no longer operated consistently with the relevant statutory principles (in Part XIC). This right to use declaration to 'reprice' wholesale ADSL would exist independently of the review process that is already part of the RMAC mechanism, scheduled for 3 years after it commences, and which will continue under Schedule 8.

Other options which Telstra is considering in relation to the pricing provisions are:

- The Wholesale ADSL Reference Price could be made available to wholesale customers in respect of ADSL 1 in any areas where ADSL 2+ is not available;
- A new, dedicated price and billing dispute mechanism which could be used by a wholesale customer to raise any dispute in relation to price equivalence issues, including disputes about its entitlement to be charged according to the Reference Price for a Reference Services, or the amount that Telstra charges where the Reference Price applies. A wholesale customer can also refer any refusal by Telstra to supply at the Reference Price to the ITA or ACCC as an Equivalence Complaint;
- Telstra is considering how it might more clearly specify the circumstances in which Telstra will not include data usage in the calculation of the RMAC price (for example, through an amendment that specified this would apply only where the cost of such usage was

'fully recovered' through other non-broadband charges, such as pay-per-view charges or content subscriptions);

K **Changes to dispute resolution measures for non-price equivalence (clauses 18 and 19 and Schedules 5 and 6)**

Under the original SSU Telstra made commitments to establish a new expedited process to resolve non-price equivalence disputes between Telstra and wholesale customers.

There were two parts to this process:

- First, Telstra committed to establish an 'accelerated investigation process' to deal with and respond to non-price equivalence complaints as they arise; and
- Second, Telstra committed to establish an independent industry adjudicator.

The feedback received from industry stakeholders indicated continued concerns about the future independence and operation of the ITA. The ACCC also questioned whether there would be effective dispute processes in place under the SSU in the event that wider industry participation in the scheme did not occur.

Telstra is looking at ways to address these concerns, including:

- The ACCC could be given a parallel power to act as the adjudicator, with the same powers under the SSU to make directions as the ITA. This would mean wholesale customers could choose whether to refer disputes to the ACCC *or* to the ITA (under both the SSU and the relevant dispute provisions under the Migration Plan, that also provide for reference of disputes to the ITA Process). In effect, if a wholesale customer has concerns about the independence of the ITA, this would make the ACCC available as an alternative. Having the ACCC as the alternative would also provide a powerful incentive for Telstra to ensure that the person to be appointed as the ITA is credible, well qualified and truly independent;
- Where the ACCC acted as the Adjudicator, it would have the power to determine its own procedures for hearing disputes. This would include the power to determine the fees (if any) that are to be paid for referring disputes to the ACCC for adjudication.
- The ITA Process would allow wholesale customers to elect whether directions are binding or non-binding at the time of referring the dispute. It may well be the case that equivalence issues are caused by a combination of problems "on both sides of the fence". Therefore, wholesale customers would need to make an up-front choice about whether they wish to be bound to fix issues on their side. If a wholesale

customer wishes to enforce the determination against Telstra, the customer would also accept that the determination can equally be enforced by Telstra against it. On the other hand, if the wholesale customer did not wish to be bound by a determination, it would also have to accept that the determination would not be binding on Telstra; and

- The adjudicator (including the ACCC) could be given the power to give directions to Telstra to change systems and processes. This scope of this power would need to be subject to the monetary caps already provided for under the ITA Process and could only be exercised in circumstances where the adjudicator is not satisfied that the proposal put forward by the relevant party complies with the directions that have been made.

L **Changes to compliance reporting measures (Part E)**

Telstra is considering a number of changes to enhance the compliance reporting obligations in Part E of the SSU, including:

- introducing a new requirement to develop a 'separation compliance program' for Telstra's structural separation commitment;
- providing further granularity regarding the issues to be covered by Telstra's annual compliance report; and
- in the event that Telstra introduced an 'overarching equivalence commitment', it would also consider monthly reporting as described in section A.