

**BEREC Guidance
on functional separation
under Articles 13a and 13b of the revised Access
Directive and national experiences**

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1. Introduction

Under the EU electronic communications regulatory framework (the Framework), each National Regulatory Authority (NRA) is required to conduct an assessment of the state of competition in specific markets and to impose proportionate remedies where significant market power (SMP) is identified.

The 2002 Framework did not explicitly provide for the possibility of NRAs imposing the remedy of functional separation on SMP operators. However, during the review process, stimulated by the discussions which had arisen in some Member States, functional (i.e. operational) separation was considered and provided for in the final package agreed in November 2009.

In its response to the October 2006 Consultation on the review of the Framework, the Independent Regulators Group and European Regulators Group (IRG/ERG) proposed the inclusion within the revised Framework of the remedy of functional separation. In September 2007 ERG issued an “Opinion on Functional Separation” where it stated the view that functional separation can be considered as a supplementary remedy in markets where non discrimination has been shown to be ineffective in dealing with problems of equivalence in wholesale markets¹.

Functional separation has already been implemented in some Member States by means of voluntary undertakings offered by vertically integrated incumbents. This document will refer to these cases to draw examples on how functional separation can be implemented from a practical point of view. A more detailed description of these national experiences can be found in Annex I. However, these national cases should be understood in a context where no specific provisions regarding functional separation were present in the EU Framework. In addition, given that functional separation has not so far been adopted as a mandatory obligation in the electronic communication markets, the existing examples, based on voluntary commitments, will be limited to providing guidance on particular implementation issues related to Article 13a. Functional separation has also been undertaken in other regulated sectors such as the electricity and gas markets in EU Member States.

Following the recent review process of the EU Framework, the Better Regulation Directive (approved in November 2009)² introduced functional separation as a non-standard remedy. Unlike standard remedies which are subject to the Articles 7 and 7a of the Framework Directive procedures, the remedy of functional separation is subject also to a prior approval procedure. The revision to the Framework also anticipates voluntary separation by an SMP operator. The two provisions are set out in Articles 13a and 13b of the Access Directive.

The revised provisions are required to be transposed by Member States into national law by May 2011.

The aim of this document is to provide guidance – capable of being applied to national circumstances – that can be used by NRAs when considering the appropriateness and the implementation of functional separation under Articles 13a and 13b of the Access Directive.

¹ http://erg.eu.int/doc/publications/erg07_44_cp_on_functional_separation.pdf

² <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:337:0037:0069:EN:PDF>

2. Guidance on functional separation in the revised Framework (Articles 13a and 13b of Access Directive)

2.1. Functional separation as a non-standard remedy (Article 13a)

The revised Framework has introduced the possibility for NRAs to impose functional separation as a non-standard remedy. As an exceptional measure it requires specific conditions and special procedures before it may be imposed. The procedures are set out in Article 8(3) of the Access Directive and empower the Commission, taking the utmost account of the opinion of BEREC, to take a decision to authorise or prevent an NRA from imposing functional separation as a remedy.

This section considers the provisions of Article 13a and issues that may arise from its application by NRAs. It is not meant to provide an exhaustive list of indicators/criteria whose application would automatically lead an NRA to conclude that functional separation is required in order to solve the competitive problems of the market. As an option available to NRAs, functional separation should only be proposed after the relevant markets have been analysed in a coordinated manner, taking due account of all national circumstances and specificities.

2.1.1. Meaning of functional separation

Article 13a defines the obligation of functional separation as “*an obligation on vertically integrated undertakings to place activities related to the wholesale provision of relevant access products in an independently operating business entity. That business entity shall supply access products and services to all undertakings, including to other business entities within the parent company, on the same timescales, terms and conditions, including those relating to price and service levels, and by means of the same systems and processes*”.

This section intends to provide a brief description of the possible forms of separation, with specific focus on functional separation. The concept of “Functional Separation” is often linked with the concept of “Equivalence of Access”, by which the separated unit is required to supply access products and services on an equivalent basis to all communication providers, including the downstream arms of the separated undertaking. Section 2.1.5 below will then discuss what types of access products could be required to be offered on a fully equivalent basis and be traded by the separated arm, i.e. where the NRA can draw the boundary between the equivalent products and the rest of the incumbent’s wholesale products.

The economic literature³ specifies that the split within the firm can happen at two levels: between wholesale and retail or between access and other wholesale products. In particular, a typical vertically-integrated communication provider can isolate three main activities: Retail, Wholesale Access Products, and Wholesale non-Access Products. Article 13a, however, explicitly refers to functional separation as an “*obligation on vertically integrated undertakings to place activities related to the **wholesale provision of relevant access products** in an independently operating business entity*” (emphasis added). Therefore, this document refers to the separation between wholesale access products and the remaining wholesale products.

The primary argument for introducing vertical separation is that it reduces or (in the extreme) eliminates the incentive of the incumbent network operator to engage in non-

³ Martin Cave and Chris Doyle, “Network separation and investments incentives in telecommunications,” Warwick Business School, University of Coventry, UK.

price discrimination in favour of its own retail operations. In particular, it eliminates the incumbent's incentives and possibilities, whether legal, economic or technical, to maximize the profits of its own downstream divisions via discriminatory practices⁴. In the absence of separation, the incumbent has incentives to maximize the joint profits of its upstream network operations and its downstream retail division by using such practices.

The term “functional separation” is defined in Recital 61 of the Better Regulation Directive: “*The purpose of functional separation, whereby the vertically integrated operator is required to establish operationally separate business entities, is to ensure the provision of fully equivalent access products to all downstream operators, including the operator's own vertically integrated downstream divisions*”. The recital then underlines the benefits of functional separation, where other remedies have not worked, to reduce the firm's incentives to discriminate, but reminds also that “*it is very important to ensure that its imposition preserves the incentives of the concerned undertaking to invest in its network and it does not entail any potential negative effects on consumer welfare*”.

The economic literature outlines three broad kinds of separation:

- a. Structural separation
- b. Functional (Operational) separation
- c. Accounting separation

At the extremes – structural and accounting separations – the terms are relatively unambiguous. Under accounting separation, the vertically integrated firm is required to follow specified accounting conventions for allocating the costs and revenues of upstream and downstream services into separate baskets, hence allowing regulators to set wholesale prices for upstream services. The benefit of accounting separation is that it preserves the vertically-integrated structure of the firm thereby preventing the loss of vertical efficiencies. On the other hand, accounting separation does not prevent non-price discrimination conducts.

Under full structural separation, the firm that operates a network and provides services over it, is split into a) a company owning the local access network and providing wholesale access to service providers; and b) another company providing retail services. In this case the firm is literally divided in two entities with different ownership, management, etc. Article 13a does not deal with accounting separation, which can be adopted by the NRA as a standard remedy. Nor does it refer to structural separation which could in principle be imposed under competition law.

Between the two extremes, there are a variety of options, typically referred to as “operational” or “functional” separation. Martin Cave's definition of separation, namely the ‘six degrees of separation’, is set out in Table I. At the bottom, level 0, there is the accounting separation as defined above, whereas the top level, 6, is characterised by the split of the firm's ownership.

Degree	Separation option	Description
6	Ownership separation	As 5 but with different ownership.
5	Legal separation (separate legal entities with the same ownership)	As 4 but with a separate non-executive board.
4	Functional separation with localised	As 3 plus different managers' incentives and different

⁴ Paul W. J. de Bijl, “Structural Separation and Access in Telecommunication Markets,” CESifo Working Paper n. 1554.

	incentives and/or separate governance arrangements	governance.
3	Functional separation	Physical separation of businesses and new business practices, e.g. new office location, new brand, separate OSS, separate management info systems.
2	Virtual separation	First form of equivalence of access as internal and external customers are treated equally. No physical separation of the businesses.
1	Creation of a wholesale division	The incumbent has a separate wholesale division which supplies upstream inputs to competitors. The retail arm still has a preferential way to access products. No equivalence of access.
0	Accounting separation	Costs and revenues of upstream and downstream products are allocated in different baskets. Preserves efficiency of vertical integration but does not provide equivalence of access.

Table I

Level 1, the creation of a wholesale division, represents a step forward from accounting separation and has been adopted by many European incumbents. The wholesale division deals only with other providers who seek to purchase access products. However, the approach does not ensure equivalence, as the retail arm can have access to those products internally without interfacing with the wholesale division on the same terms as others do.

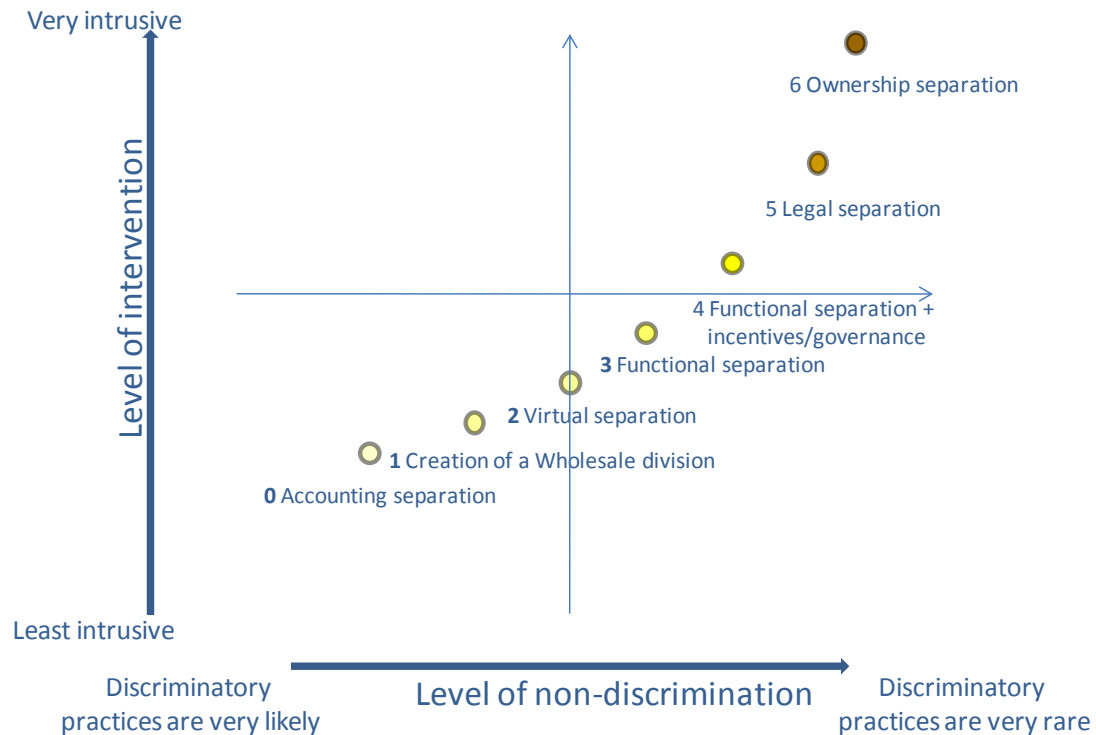
Level 2, virtual separation, enhances this model, by introducing full equivalence to the services offered to internal and external customers. This is normally achieved through the regulator imposing an obligation on the transaction boundaries to ensure that external customers are treated on equal terms, within equal timescales, etc. as the internal retail division.

Level 3, functional separation, involves a physical separation of the business and a quite substantial modification of the business practices, e.g. a different location for the new separated entity, software system separation (i.e. Operational and Support Systems (OSS)), Chinese walls, separate management information system, a new brand, etc.

The next degree, 4, involves different governance and/or different management incentives to those of the firm as a whole, e.g. bonuses and monetary incentives are not set on the basis of the overall firm's performance. In the absence of these arrangements, management may attempt to maximise group shareholders value rather than divisional profit and consequently engage in discriminatory practices against competitors. The functional separation model adopted by BT in the UK is consistent with a Level 4 separation model (see Annex I for more details).

In Cave's description, degree 5 contemplates the creation of a divisional board with non-executive members who act independently from the group board. The last degree, 6, is then another legal form of separation where the board has executive powers and separate accounts are filed. The chart below shows on a qualitative basis how the different degrees are likely to affect the incumbent's discriminatory behaviour (x axis) and how intrusive the remedy is likely to be (y axis).

Figure 1 Six degrees performance (illustrative)



In practice, as noted by Crandall et al.⁵, functional separation involves several granular decisions about how the separated firm is to operate, e.g. who is to report to whom (governance), who is permitted to talk to whom and about what topics (Chinese walls), what systems can be shared between the separated business and its retail affiliate and which ones must be duplicated (OSS separation), and who is remunerated for what, i.e. to what extent are the operators of the upstream and downstream divisions incentivised to maximise the performance of their own divisions versus the performance of the firm as a whole (incentive mechanisms)? This document will address these issues in further detail in the next sections. In general, all the elements listed in 13a(3), points a-f, represent the minimum set of elements to consider when imposing functional separation under Article 13a, therefore, among Cave's six options, only those that satisfy at least those elements should be regarded as appropriate to the submission of the draft measure.

The overall purpose of the functional separation is to ensure full "Equivalence of Access".

The equivalence of access, in general, can also have different forms of implementation, which include:

- a. Equivalence of Inputs (EoI): the downstream access product retailed by the incumbent consumes exactly the same physical upstream inputs as the downstream product supplied by competitors, e.g. same tie-cables, same electronic equipment, same space exchange etc. The product development process is therefore exactly equivalent as their provision in terms of functionality and price.

⁵ R. W. Crandall, J. A. Eisenach, R.E. Litan, "Vertical Separation of Telecommunication Networks: Evidence from Five Countries".

- b. Equivalence of Outputs (EoO): the access products offered by the incumbent operator to alternative operators are comparable to the products it provides to its retail division in terms of functionality and price, but they may be provided by different systems and processes.

In the UK, BT implements the former, while in Italy the product level equivalence adopted can be broadly classified as EoO. In practice, however, some of the systems and procedures used by alternative operators are the same as those used by Telecom Italia's retail division.

The model of equivalence that the NRA shall implement when imposing functional separation by means of Article 13a is now clarified by Article 13a(1): all the relevant access products supplied by the functionally separated division must be provided to both the incumbent's and the other operators' divisions on the same terms and conditions, within same timescales, at the same price and quality and by means of the same systems and processes.

2.1.2. Exceptionality of the measure

The exceptional nature of the remedy, in particular the fact that it is a costly, complex and intrusive measure, is reflected in the legal provisions that deal with functional separation; in the specific, non-standard procedural requirements that NRAs have to satisfy in order to be able to impose the measure; and in the burden of proof that needs to be fulfilled when justifying the necessity of the measure.

The legal provisions of Article 13a of the Access Directive (as revised) reflect the above. It states that:

*“Where the national regulatory authority concludes that the appropriate obligations imposed under Articles 9 to 13 have failed to achieve effective competition and that there are important and persisting competition problems and/or market failures identified in relation to the wholesale provision of certain access product markets, it may, **as an exceptional measure** [...] impose an obligation on vertically integrated undertakings to place activities related to the wholesale provision of relevant access products in an independently operating business entity”* (emphasis added).

Recital 61 of the Better Regulation Directive also refers to the exceptional nature of functional separation when stressing that:

*“**in exceptional cases**, functional separation may be justified as a remedy where there has been persistent failure to achieve effective non-discrimination in several of the markets concerned, and where there is little or no prospect of infrastructure competition within a reasonable time-frame after recourse to one or more remedies previously considered to be appropriate”* (emphasis added).

As a consequence, and according to the necessary analysis of proportionality⁶, following the principles listed in Article 8 of the Framework Directive, the NRA will be required, as mentioned above, to follow specific procedures to justify the implementation of functional separation in the national markets. It is important to highlight that the analysis and submissions described in Article 13a(2) and 13a(3) are due only when the NRA intends to mandate full functional separation, i.e. when the

⁶ As noted by the European Court of Justice in the *Fedesa* case, the proportionality principle, which is a general principle of Community law, requires *i)* an assessment that the measures are appropriate and necessary in order to achieve the objectives legitimately pursued; *ii)* that when there is a choice between several appropriate measures recourse is made to the least onerous; and *iii)* that the disadvantages caused are not disproportionate to the aims pursued, see Case C-331/88 of 13 November 1990, § 13.

SMP operator is required to go through a major organisational restructuring, create a separate business entity and implement full Equivalence of Access. Against this backdrop, it is worth recalling that Art. 10 of the Access Directive provides: “*Obligations of non-discrimination shall ensure, in particular, that the operator applies equivalent conditions in equivalent circumstances to other undertakings providing equivalent services, and provides services and information to others under the same conditions and of the same quality as it provides for its own services, or those of its subsidiaries or partners*”. If the NRA intends to mandate forms of equivalence falling within the scope of what is permitted under Article 10, there is no need to undertake the additional procedures as set out in Article 13a.

Unlike Articles 9 to 13 of the Access Directive for standard remedies, which do not provide NRAs with indications on how they should justify their imposition, Article 13a(2) includes concrete specifications regarding the elements that should be included in such an assessment.

Regarding the applicable procedure, such exceptional nature is reflected in the fact the provisions of Article 8(3) of the Access Directive apply, which subjects the imposition of the measure to a specific authorisation process that will end with a Decision from the Commission authorising or preventing the NRA from taking such measure⁷. It is worth noting that the remedies imposed on the markets which have been affected by a decision to implement functional separation will be revised following the usual process of market analysis according to Article 16(6) of the Framework Directive.

Finally, the exceptional nature of functional separation is also implicit in the type of internal review that an NRA will have to undertake prior to imposing this obligation. As a measure of last resort, it can be assumed that the mere formal imposition by an NRA of the wholesale obligations foreseen in Articles 9 to 13 of the Access Directive will not by itself be sufficient to reach the conclusion, in a later assessment, that functional separation is the sole remedy that can help alleviate the competitive problems detected in the marketplace. Among other factors, a “reasonable” amount of time will need to pass between the imposition of the obligations foreseen in Articles 9 to 13 and the reaching of the conclusion that functional separation is necessary.

In this regard, NRAs will also need to assess whether the standard wholesale access obligations have not only been properly imposed but also systematically enforced. For instance, due to the close links between the non-discrimination obligation and the possible consideration of functional separation as a remedy, the existence of a substantial track record of enforcement activity against the SMP operator regarding instances of discrimination may assist an NRA in reaching the conclusion that functional separation should be assessed as a regulatory option. Likewise, the existence of additional measures that are ancillary to the non-discrimination obligation, such as regulatory measures that aim to assess the internal procedures implemented by the SMP operator when self-supplying the wholesale inputs to its retail arm, or publication of key performance indicators which allow service to third parties to be compared with the service provided to the SMP player’s retail arm, may also assist an NRA in concluding that, regardless of these measures, the evolution of the competitive landscape still requires consideration of a more intrusive measure such as functional separation. Obviously, the kind of enforcement activity in the application of the standard wholesale obligations will vary in each specific case, and will be dependent upon national circumstances such as the degree of enforcement scrutiny that can reasonably be expected from an NRA.

⁷ In this process, the Commission must take utmost account of the opinion issued by BEREC and by the Cocom according to the advisory procedure.

In summary, due to the nature of functional separation as a measure of last resort, it will be the task of the NRA to assess whether the wholesale obligations foreseen by Articles 9 to 13 have been properly designed and have been consistently applied. If the answer to this question is in the negative, the NRA should evaluate to what extent a more comprehensive design and stricter enforcement of the wholesale measures covered by Articles 9 to 13 of the Access Directive may be sufficient to remedy the competition problems that have been detected, without the need to resort to functional separation.

2.1.3. Procedures

Where an NRA considers that functional separation is justified as an SMP remedy as discussed above, that remedy requires the prior approval of the Commission. According to the provisions of the new framework, when wishing to impose functional separation, the NRA undertakes the following actions:

- Conclude that the appropriate SMP obligations imposed under Articles 9 to 13 of the Access Directive following the market review have failed to achieve effective competition (Art. 13a(1)).
- Proposal to the Commission: carry out the analysis detailed in Article 13a(2), points a, b, c, d (described in section 2.1.4 of this document). This analysis forms the basis of the “proposal to the Commission”.
- Remedies stage and draft measure: the draft measure must include all the elements listed in Article 13a(3), points a-f. See section 2.1.5 for more details.
- Submit the proposal and the draft measure to the Commission in accordance with the procedures set out in the second paragraph of Article 8(3) of the Access Directive.
- Advisory stage: the Commission evaluates the NRA’s proposal and draft measure. BEREC and Cocom shall provide an opinion to the Commission. The Commission communicates its decision to the NRA, having taken utmost account of BEREC and Cocom’s opinion.
- Impact on current regulation: the NRA undertakes a coordinated analysis of the markets related to the separated access products following the procedure in Article 16 of the Framework Directive. This is to assess how the current SMP obligations can co-exist with the newly introduced functional separation.
- Changes to the current regulation: following the above assessment, the NRA can decide to impose, maintain, amend or withdraw obligations in accordance with Articles 6 and 7 of the Framework Directive.

The procedures set out below are prescribed by a combination of provisions in the revised Framework.

Market analysis procedure.

Recital 61 of the Better Regulation Directive states “*When undertaking the market analysis and designing the details of this remedy, national regulatory authorities should pay particular attention to the products to be managed by the separate business entities, taking into account the extent of network roll-out and the degree of technological progress, which may affect the substitutability of fixed and wireless services.*” On this basis, the imposition of functional separation derives from the market

analysis of all the relevant access products that will be required to be supplied by the separated business entity, e.g. separation of bitstream access and local access, can only be imposed after analysing both these markets.

On the basis of such market analysis, the next step is for NRAs to determine whether the relevant market is effectively competitive and to identify the undertaking(s) having SMP.

The imposition of functional separation.

Once the NRA has determined the uncompetitive condition of the affected markets and has designated the vertically-integrated operator as having SMP, it should first demonstrate, in order to impose functional separation, that this remedy is based on the nature of the problem they have identified, proportionate and justified in light of the policy objectives laid down in Article 8 of the Framework Directive.

Article 13a requires that NRAs submit such request to the Commission for its prior approval. In particular, Article 13a requires the NRA to submit a proposal (Art. 13a(2)) and a draft measure (Art. 13a(3)). Although Article 13a is silent on whether both requirements have to be submitted jointly, it should be noted that Article 13a(4) specifies that the Commission's decision will be taken on the draft measure.

Sections 2.1.4 and 2.1.5 provide details on the contents of the proposal and the draft measure to be submitted to the Commission.

BEREC's opinion.

Under the provisions of Article 8(3), a BEREC's opinion on a proposed imposition of functional separation is required before the Commission can decide whether or not to authorise the NRA. The Commission is required to take the utmost account of the BEREC's opinion in reaching its decision. When it has done so, the Commission is then required to consult the Communications Committee (CoCom) and to take the utmost account of its opinion.

The advisory procedure.

In approving any exceptional measure the Commission must act in accordance with Article 14(2) of the Access Directive, which refers to the advisory procedure under Comitology. This means that in its decision approving an NRA proposal to impose functional separation, the Commission shall be assisted by the CoCom, which shall provide an opinion on the draft measure. The Commission shall take the utmost account of the opinion delivered by the committee and shall inform of the manner in which the opinion has been taken into account.

Coordinated analysis stage and imposition of remedies in affected markets.

Article 13a(4) provides that "*Following the Commission's decision on the draft measure taken in accordance with Article 8(3), the national regulatory authority shall conduct a coordinated analysis of the different markets related to the access network*" and, on the basis of this analysis, the NRA shall "*impose, maintain, amend or withdraw [existing] obligations*" in accordance with the procedures in Articles 6 and 7 of the Framework Directive.

The coordinated analysis has the aim of assessing whether the existing regulatory remedies, following the imposition of functional separation, need to be maintained, amended or withdrawn. Once the Commission approves the exceptional remedy, the NRA is required to carry out this assessment. For example, as a consequence of

imposing functional separation, the NRA may find that retail markets can be partially or totally de-regulated.

The Directive is silent on the time-frame for this and it would be reasonable to allow some time for the imposed measure of functional separation to have an effect. It should be noted that the Directive at Article 13a(5) makes clear that an SMP operator who is subject to an obligation of functional separation may also be subject to any of the standard remedies listed in Articles 9 to 13 (and any other “exceptional” measures) if these are warranted by the results of a market analysis. However, it is reasonable that NRAs would not maintain current remedies when separation remedies have been implemented and adequately address the market failures.

2.1.4. Contents of the proposal to the Commission

This section addresses the main criteria that should guide the analysis undertaken by the NRA prior to the submission of a draft proposal to the European Commission. The content of the draft proposal is dealt with in Article 13a(2).

As previously stated, this document does not aim to provide an exhaustive list of indicators and thresholds to conclude on whether functional separation should be applied. The intention is rather to provide some guidance on the elements of analysis that NRAs should take into account when applying the provisions of Article 13a. The final decision will therefore be the result of a national analysis that takes due account of the specificities of the national markets.

Article 13a(2) lists the elements of the analysis that the Commission expects NRAs to include when submitting a proposal to impose functional separation. There are two main elements:

- Firstly, the NRA has to provide evidence justifying its conclusions that the conditions of Article 13a(1) are met, i.e. that *“the appropriate obligations imposed under Articles 9 to 13 [standard remedies] have failed to achieve effective competition and that there are important and persisting competition problems and/or market failures identified in relation to the wholesale provision of certain access product markets [...]”* (Article 13a(2)(a)). Such analysis is intended to provide evidence that this remedy is appropriate and proportionate. The NRA must also show that *“there is little or no prospect of effective and sustainable infrastructure-based competition within a reasonable time-frame”* (Article 13a(2)(b)) and that functional separation would be the *“most efficient means to enforce remedies aimed at addressing the competition problems/markets failures identified”* (Article 13a(2)(d)).
- The second element refers to an impact analysis, which is not required for the standard remedies and reflects the exceptionality of the measure. Specifically, NRAs are required to assess the impact on the regulatory authority, the undertaking, the electronic communications sector as a whole, incentives to invest in a sector as a whole, and on other stakeholders including impacts on competition and on consumers (see Article 13a(2)(c)). In terms of benefits, Recital 61 notes that functional separation has the capacity to improve competition in several markets by significantly reducing the incentive for discriminatory practices by the incumbent. In terms of possible costs, the Recital finds that it is also very important for NRAs to ensure that its imposition preserves the incentives of the incumbent to invest in its network and does not entail any negative effects on consumer welfare. The incumbent’s costs are likely to include the costs of separation and costs of re-

location and re-branding (if required). It is worth noting that a quantitative assessment of both benefits and costs is likely to be very challenging.

The following paragraphs provide details of each of the two elements.

- **Assessment of the need to impose functional separation**

As mentioned, first of all the NRA will need to establish that the imposition of this non standard measure is justified.

As extensively covered by the economic literature, a vertically-integrated undertaking has high incentives to engage in a range of discriminatory tactics. In particular, it is likely to discriminate on non-price parameters, such as denial to access to services self provided to its own retail arm, delaying the processing of orders, or providing detailed advance information to the vertically-integrated operator's own downstream business operations before making it available to competing downstream customers, in order to give advantage to their own downstream operations to the detriment of their (competing) upstream customers.

ERG extensively deals with the different issues related to non-price discrimination and the ways to remedy it in its revised CP on remedies of June 2006 (ERG (06) 33). However, such behaviour can be difficult to detect by the NRA, meaning that by the time evidence has been found and remedies applied the damage to competitors has already been made. The standard remedies designed to avoid discriminatory practices by the vertically-integrated SMP operator may be therefore insufficient to address the problem.

Where such standard remedies have failed and there are important and persistent competition problems and/or market failures, functional separation can be an appropriate way to address competition problems. It is specifically designed to tackle non-price discriminatory practices, as it significantly reduces or eliminates the incentives and ability of the vertically-integrated undertaking to discriminate.

Despite the fact that these incentives exist and functional separation could arise as an additional tool for NRAs to deal with discriminatory behaviour by the incumbent operator, due to its uncertainties, the imposition of such a measure should be balanced considering both the expected benefits in solving the competition problems and the costs of taking this decision. In particular, it should be compared to the situation when all other available obligations have been imposed and enforced in a consistent manner.

The starting point of the analysis provided by Article 13a is the requirement for the NRA to conclude "***that the appropriate obligations [...] have failed to achieve effective competition and that there are important and persisting competition problems and/or market failures identified [...]***" (emphasis added). Therefore, not only should the NRA come to the conclusion that the imposition of the appropriate measures within the standard set of available remedies (and the NRA's attempts to enforce them over a reasonable period of time) has been ineffective to solve the competition problems in the access markets, but also that those competition problems are *important* and *persistent*.

In other words, if a market assessment shows that competition is not effective – due essentially to significant and persistent discriminatory practices by the SMP operator, despite the efforts of *ex ante* regulation – and that there is little or no prospect of evolution towards effective and sustainable competition in a reasonable time-frame, functional separation could be deemed as appropriate.

For this purpose, the NRA could take into account the following:

- The existence of structural barriers to entry

In order to assess the degree of replicability of the relevant assets, the NRA should investigate and verify the existence of structural barriers to access. The absence of alternative access infrastructures (to that of the incumbent operator) would provide the NRA with essential evidence on the existing obstacles to entry. Additionally, the persistence of the bottleneck should be investigated.

If the NRA reaches the conclusion that access to the incumbent's network is not essential, given that viable alternative infrastructures exist or could be foreseen in the short/medium term, discriminatory practices may not be assumed to have such a relevant impact on the competitive conditions such as to justify imposing functional separation.

- The persistence of the competition problems

In order to conclude on the persistent character of the competition problems or market failures, both a historic and prospective perspective could prove to be valuable to the analysis.

NRA's could consider a range of different indicators for this purpose. Some examples include:

- market shares and their trends over time (dominance of the incumbent in both wholesale and retail markets);
- increase in disputes between the incumbent and alternative operators regarding discriminatory practices;
- persistent problems of discrimination;
- retail market structure, assessing whether the behaviour of the SMP operator prevents alternative operators from offering viable services in terms of price packaging, quality of service, or commercial and technical features (e.g. does the retail market see alternative offers based on LLU?).

As highlighted by the wording of Article 13a(2), the prospect of alternative infrastructures will impact the NRA's assessment of the persistent character of the competition problems. More specifically, the Article points to the existence of "*no or little prospect of effective and sustainable infrastructure-based competition within a reasonable time-frame*" as a prerequisite to conclude on the need for functional separation.

While functional separation is recognised to be beneficial in the promotion of intra-platform competition, its effects on infrastructure-based competition may be detrimental.

Therefore NRAs will need to assess the likelihood of investments in new access infrastructures by alternative operators. The time perspective is important in this assessment, as the effects of functional separation can be different in the short and in the medium/long term.

On the one hand, in the short term functional separation may be a solution to the uncompetitive conditions of the market. It may encourage investments since it gives greater legal certainty to both incumbent and new market entrants and may help to unblock the problem whereby dominant carriers can delay investments in access upgrades to avoid cannibalising downstream revenues. On the other hand, in the long term it may lead to a reduction of incentives for other operators to invest in alternative access infrastructures, thereby inhibiting infrastructure-based competition in the access

network. This may be caused by all market players sharing the same infrastructures under exactly the same conditions.

The evaluation on whether the benefits outweigh the cost of imposing such a measure is one of the most difficult issues to be addressed by the NRA. The following paragraphs propose a number of criteria that could be taken into account in the analysis.

- **Assessment of the impact of imposing functional separation**

Given the risk of regulatory failure of such a costly and intrusive measure, in particular taking into account that it has never been adopted as a mandatory obligation so far in the telecom markets, the impact analysis that NRAs will have to undertake could become the most difficult aspect of the whole analysis.

According to Article 13a(2)(c), NRAs shall assess the impact of the imposition of functional separation from several points of view, which includes the effects on the NRA, on the undertaking and on the sector as a whole, with a special view on the workforce, on the incentives to invest, taking into account social and territorial cohesion, and on the overall competitive situation and on consumers. Therefore, the decision to impose functional separation cannot be only based on market analysis tools but has to incorporate a more comprehensive analysis.

The following paragraphs try to provide some guidance on the main elements such an analysis could cover, given the aspects listed in Article 13a(2)(c):

- Impact on the NRA

Disadvantages: the imposition of functional separation on the incumbent could result in a significant increase of the workload on the regulatory authority. In the scenario of compulsory separation, the NRA has to decide which activities should be provided by the new entity, the assets related to these activities, the resources to ensure an efficient operation, etc. The capacity and resources of the NRA to impose and manage this measure on an ongoing basis should be considered as they are a key element to ensuring its effectiveness.

Advantages: once imposed, functional separation could ease the regulatory burden, as discriminatory practices by the vertical-integrated operator should not engage the regulator to the same degree and the number of inter-operator disputes should show a decrease. This could lead to outcomes that enable downstream regulation to be removed in due course.

The concrete balance of these pros and cons should be carefully assessed by the NRA, taking into account its capacities and the market structure.

- Impact on the undertaking and the sector

NRAs should also analyse the impact of functional separation both on the incumbent, giving particular attention to the workforce, and on the whole electronic communications sector.

Disadvantages: it is clear that the imposition of this measure would have a significant impact on the incumbent as it will necessarily be obliged to change the way it functions, incorporating new processes and steps between the separated

entity and the retail arm. In other words, the incumbent may incur high costs to implement separation.

Advantages: the impact on the whole sector might be more difficult to foresee, as there is not a clear direct impact other than solving the discriminatory practices. However, this should lead to significant gains for the sector as alternative operators should find the process of obtaining access more efficient than was previously the case.

Finally, it should be noted that the focus on the labour force seems to impose on NRAs a requirement to determine the net impact of the measure on employment in the sector. While there may be a direct impact of functional separation in employment terms, both gains and losses in some areas, changes in employment numbers to meet business requirements are not of themselves an indicator of either a positive or negative impact. A more efficient process might lead to a reduction in direct labour force requirements but this can be outweighed by the possibilities of redeploying staff to other productive tasks.

- Impact on the incentives to invest

The other key element to be considered in the impact analysis is the effect on the overall incentives to invest. In the economic literature it is possible to find the view of those who argue that functional separation will reduce these incentives on both the incumbent and alternative operators. Functional separation implies a reinforced access obligation as the activity of the separated entity is focussed on the wholesale provision of services. This fact facilitates entry to alternative operators as they can use these wholesale services under regulated conditions, including prices. In these conditions, all operators, including the incumbent, may have reduced incentives to invest as the costs of rolling out their own infrastructures are likely to be higher than the costs of purchasing the services offered by the separated entity. However – as is the case also for a fully integrated SMP operator – price regulation taking account of economies of scale and scope can mitigate these effects. Experience has shown that the ladder of investment coupled with consistent access pricing (the “right space” between the steps of the ladder) allows alternative operators to climb up the ladder by investing in their own infrastructure in parallel with the build-up of their customer base. Equivalence could lead competing operators to invest in intermediary infrastructure (e.g. LLU), which may in turn incentivise the incumbent to invest in newer infrastructure (e.g. NGA).

However, the scope of this analysis seems to have been broadened as NRAs should also consider the impact on investments in the sector as a whole particularly with regard to the need to assure social and territorial cohesion. Regarding this aspect, it may be implicit that an integrated firm could more efficiently ensure these objectives of social and territorial cohesion, but it should be noted that these objectives can be pursued by applying the Universal Service Directive (Article 23a) through accessibility measures and Universal Service Obligations.

Finally, in a context of transition to next generation access networks, the impact on NGA investments should be carefully assessed by the NRA. The incentives to invest in these new networks by the incumbent could be deterred if it anticipates that the new assets could be transferred to the separated entity. Therefore, the NRA should consider individually the imposition of functional separation of assets related to NGA. It should be noted though that such an assessment is not simple or straight forward. For example, an incumbent with a relatively weak retail market share (e.g. in broadband) may have a higher incentive to invest in NGA if it

perceives functional separation to offer a higher degree of certainty for its wholesale business than would otherwise be the case.

- Impact on competition

This criterion is the most relevant to the current activities carried on by NRAs. The provision of wholesale services in a transparent and non-discriminatory way is a key element to avoid distortions in communications markets, once infrastructure competition is shown to be unfeasible⁸. On the other hand, as said before, the time-frame required to implement the measure should be considered as a key element of its effectiveness.

- Impact on consumers

The last criterion listed in Article 13a(2)(c) refers to the impact of the measure on consumers. In principle, an improvement in the competition conditions should increase consumers' welfare, as they could get a better deal in terms of lower prices and more innovative offers. This is also true in the long term, as the NRA has to show that the positive effects of the measure overrule negative effects regarding incentives to invest. At this point, it is difficult to foresee additional elements to take into account regarding this criterion.

The approach described above requires an assessment of the evolution of several variables in the short/medium term. This may result in a high level of uncertainty in the final result. Therefore, if the impact analysis is carried out by means of a cost-benefit analysis the NRA may decide to complement the impact analysis with a sensitivity analysis – although it is not a criterion of analysis listed under Article 13a – in order to test the robustness of the hypothesis considered.

Finally, Article 13a(2)(d) requires NRAs to show that functional separation “*would be the most efficient means to enforce remedies aimed at addressing the competition problems/markets failures identified*”. To this end, together with the analysis described above (on the need for and the impact of the measure), the NRA could include an assessment of other possible regulatory/legal options available to solve the issues identified (these would not include market remedies, which would have already proved to be insufficient), with the conclusions on the reasons why functional separation is considered the most efficient remedy⁹.

In conclusion, having demonstrated through the above analysis the overall benefits of functional separation, established that existing remedies, effectively applied, have failed to address identified competition problems, and shown that any alternative regulatory solutions would be less efficient, the logical conclusion is that the imposition of functional separation on the SMP operator would be justified.

2.1.5. Contents of the draft measures

Under Article 13a(3), the draft measures, similar to the proposals, shall include certain mandatory elements and also have to be submitted to the Commission, which has to decide upon them in accordance with Article 8(3). While the proposal has to show and demonstrate that the measure is proportionate and appropriate, the draft measures

⁸ As mentioned above, the Directive requires market failures to have been both *important* and *persistent*. If both requirements are not fulfilled, the expected benefits of functional separation, i.e. improving competition, may not outweigh its costs.

⁹ A similar analysis was conducted by Ofcom in 2004/2005 in their strategic review of Telecommunications: http://www.ofcom.org.uk/static/telecoms_review/index.htm.

have to include a detailed description of the functional separation obligation that the NRA intends to impose.

The draft measures are required to include these elements:

- a) *“the precise nature and level of separation, specifying in particular the legal status of the separate business entity”.*

A different combination of processes, systems and organizational measures, as well as the choice of products provided by the separated entity, will create different types or degrees of separation.

According to Article 13a of the Access Directive NRAs can *“impose an obligation on vertically integrated undertakings to place activities related to the wholesale provision of relevant access products in an independently operating business entity”.*

Taking into account that this provision refers to an independently operating “business entity”, the imposition of the separation into a legally separate undertaking sited within the same group is possible. This provision would otherwise not refer to a separate “business entity” but rather to a separate “business unit”. This is supported by Article 13a(1) where it states *“that business entity shall supply access products and services to all undertakings, including to other business entities within the **parent company** [...]”* (emphasis added), leaving the option to apply a range of degrees of functional separation (see Table I on functional separation degrees) up to the aforementioned legal separation.

When informing the Commission about *the “precise nature and level of separation, specifying in particular the legal status of the separate business entity”* the NRA should therefore explain in detail which of the aforementioned degrees of functional separation (or combinations of those) will be imposed.

- b) *“an identification of the assets of the separate business entity, and the products or services to be supplied by that entity”.*

One of the most important issues is the identification of the perimeter of the infrastructure involved and the range of services that the separated business entity will offer. For this purpose, NRAs have to identify the assets and the associated services that can be considered as essential facilities. The tangible assets could include all network parts belonging to the access network including ancillary elements necessary to run it. These again would be determined by the products or services to be supplied by the separated entity. Intangible assets, such as intellectual property and human capital, would also have to be clearly assigned to the separated entity.

Since the evaluation is influenced by technology development and in particular by the development of NGNs, these have to be borne in mind making it necessary to make a prospective outlook when identifying the assets. Taking this into account, market players would need to have access to products or services in a non-discriminatory way. NRAs therefore would have to make sure that either equivalence of input or equivalence of output is guaranteed by the separated entity.

When deciding on the form of separation, the NRA should also carefully consider where to draw the boundary of the access products to be separated. For instance, a broad distinction could be the following:

- a. Non-Access Network: core network services; call origination, termination, transit; trunk segments of leased lines; some backhaul, e.g. very high bandwidth backhaul or backhaul in some geographical areas;
- b. Access Network: unbundled local loop; wholesale line rental; tail segments of leased lines; remaining backhaul.

However, such a distinction is not always straightforward. Some questions may arise such as whether wholesale broadband access should be included among the access network products traded by the functionally separated entity or whether the backhaul should be completely or partially included among the equivalent products.

There could be national cases where the upstream input to broadband services is a persistent economic bottleneck and regulators have already adopted measures to remedy the SMP position in the market. The decision on whether to include such products is thus left to the NRA on the basis of the specific national case.

In the UK, bitstream access was one of the first equivalent access products (BT IPStream). At the time, the UK was lagging behind in terms of broadband take-up and BT had a very large share of the wholesale market. Ofcom recognised that LLU was not economically viable for the whole of the national geography and that competitors would largely benefit from a bitstream product in locations where unbundling the loop would result in an economic loss. Once subsequent market analysis concluded that some UK geographic areas were no longer characterized by SMP, Ofcom exempted BT from the obligation to supply the bitstream access on an equivalent basis in those areas.

In Italy, as well as in the UK, bitstream access was included among the separated access products to be provided on an equivalent basis. The reason was that in some geographical areas alternative operators cannot benefit from LLU services since they are not economically viable. It is worth noting that Telecom Italia has a very large share in wholesale broadband market.

Similarly to the case of bitstream access, an important decision for the NRA concerns the inclusion of backhaul services among the equivalent products traded by the separated unit. In most of the national cases, backhaul services are considered enduring economic bottlenecks. Therefore, in those circumstances where the backhaul market is found to have SMP, the NRA should require this product to be supplied by the separated access division. The inclusion of backhaul may however be limited to the specific bottleneck assets, i.e. the NRA may require equivalent access to backhaul only of certain data speeds or in some specific geographical areas.

- c) *“the governance arrangements to ensure the independence of the staff employed by the separate business entity, and the corresponding incentive structure”.*

The independence of the staff can be addressed through a set of rules that the incumbent must follow, especially about the way that information is used and spread in the organisation. Chinese walls between the separated entity and the other entities would ensure that information is not spread such as to disadvantage competitors. These rules may be reinforced by the physical separation of offices, or secured areas within office buildings, as well as by different management structures separating the one responsible for the separated entity from the rest of the group, thus preventing influence and control by group members. The latter may include independent investment planning and approval. This may imply that management

and employees' remuneration be conditioned by the separated entity's performance only. These rules may also include a physically separate IT system that the separated entity would have to operate independently as well as a separate legal division. If the IT system is integrated at group level, Chinese walls would have to make sure that no information is being leaked between the separate entity and the rest of the group. This would also hold true in case the legal division responsible for the separate entity is located within a central legal service at group level.

Moreover, the vertically integrated company will probably have to provide the NRA with details of the procedures to be put in place to regulate information sharing within the company along with associated internal compliance measures and monitoring.

Bonus and incentives schemes should be linked to the separated entity's objectives rather than to the ones of the whole company in order to ensure the independence of the staff.

d) *"rules for ensuring compliance with the obligations"*.

The draft measures should define a body which would be responsible for monitoring and ensuring compliance with the obligations and aims of functional separation. Tasks of the compliance body could include investigating complaints between the separated entity and its customers, monitoring and reporting to NRAs. In order to ensure compliance with the obligations of functional separation, there are some possibilities that could be applied.

One of the options could be the creation of a board which independently monitors whether the separated entity is meeting its obligations to provide non-discriminatory access (see Annex I for case in UK and in Italy). Another alternative to setting up a board would be to appoint a compliance officer, who would be located within the separated entity. The board or the compliance officer would be responsible for setting up a compliance program to monitor that obligations are being met (see point f for detailed example), monitoring key performance indicators and making recommendations for improvements. Additionally the board would also be responsible for investigating complaints. The NRA should detail the powers of such a board or compliance officer (surveillance, reporting to NRA, etc.). In order to preclude any prejudice at least the majority of the board members would have to be appointed or approved by the NRA. Such a board may be supported by a body closer to the functionally separated entity which serves as a contact point for both the board and customers of the separated entity.

Another option would be that the NRA itself monitors the functional separation. This could be done via regular audits or via commission of an independent audit (see point f).

It could be also created a body aimed at mediating technical and operational conflicts between the separated entity and its customers and reporting to NRAs.

e) *"rules for ensuring transparency of operational procedures, in particular towards other stakeholders"*.

When designing the changes to the OSS, the incumbent needs to take into account the other operators' needs and views.

If regulatory obligations of transparency, reference offer and/or non-discrimination are revoked or modified in the course of functional separation, the draft decision

may have to contain provisions to ensure equal and transparent access to the services of the functionally separated entity.

- f) *“a monitoring programme to ensure compliance, including the publication of an annual report”.*

First of all, it could be important to define precise objectives to guarantee the equality of treatment by the separated entity. Related to this, it could be appropriate to define which indicators have to be considered to monitor the performance (for example, indicators related to delivery and assurance processes, availability of the network elements and services, product equivalence, behavioural metrics, etc.). The monitoring programme should also contemplate measures guaranteeing the transparency of its results/output.

One possibility could be that the separated entity has to submit a compliance program and a regular report on it. The compliance program would contain a description of the separated entity (e.g. including information on the organisation structure of the separated entity, a plan on how the business is run with regard to independence and decision making, etc.) and measures for guaranteeing non-discrimination (e.g. an evaluation of business processes, how information is used, duty of staff, compliance management, etc.). The compliance report would set out whether the conditions of the compliance program have been met, and would have to be submitted regularly (e.g. yearly).

It may be helpful to impose the provisioning of other reports in addition to the annual one. This could include publishing key performance indicators and a report of whether these have been met. It could be also useful to request the publication of reports on complaints received by the separated entity.

2.2. Voluntary separation by a vertically integrated undertaking (Article 13b)

The revised EU regulatory framework has introduced, at Article 13b of the Access Directive, the obligation for vertically integrated SMP operators to inform the NRA of their intention to adopt and implement some form of separation of their local access network activities.

This section discusses the provisions of Article 13b and the issues that may arise from its application by NRAs. In this respect, the experience gained in some Member States (UK, Italy, Sweden, Poland) with the voluntary separation of the access network of their national incumbent operators might provide some useful guidance.

EU countries like UK and Italy have implemented functional separation by means of voluntary commitments of SMP operators, which were subsequently accepted by national regulatory authorities in accordance with national laws (see Annex I). In Poland an Agreement was signed between the incumbent and the President of UKE under which the former committed to separate some access activities (see Annex I). The Swedish incumbent, too, has voluntarily separated its access network and adopted some ancillary measures aimed at improving non-discrimination. In this case, however, the NRA has not formally endorsed those measures, deeming them not able to bring any major improvement to the competitive conditions of access markets. Consequently the access network separation was only briefly mentioned in the market analysis and access services regulation resulted unaffected by the voluntary separation.

All the above voluntary arrangements did not derive from the application of the EU Framework. They were rather linked to the specific situation of the incumbent operator and the national market. Moreover, they came about as a result of different legal contexts. However, since they were submitted from incumbents to NRAs as voluntary undertakings and resulted in functional separation of access network assets, we believe they may provide useful examples.

2.2.1. Scope of the rule

According to Article 13b, SMP operators have to inform the NRA when they intend: i) “to transfer their local access network assets or a substantial part thereof to a **separate legal entity** under different ownership”, or ii) “to establish a **separate business entity** in order to provide to all retail providers, including its own retail divisions, fully equivalent access products” (emphasis added).

The obligation for an SMP operator to inform the NRA of its intention to separate the local access network applies to functional separation as well as structural separation. The rule has therefore an extended scope with respect to Article 13a, where structural separation cannot be imposed as an exceptional remedy¹⁰.

In conclusion, in the context of voluntary separation, Article 13b requires the NRA to take note of the incumbent’s decision and to analyse the impact of the proposed separation, either structural or functional, on the access markets. In this regard it should be noted that Article 13b does not provide for any form of differentiation between the two cases. Subject to the common general principles set out in the Article, NRAs have thus discretion to decide on the precise criteria for the assessment that would apply to each type.

2.2.2. The role of the NRA: assessment of the transaction and modification of existing regulation

As outlined above, Article 13b places an obligation on the SMP operator to inform the NRA where it intends to carry out a voluntary separation of its access network business units. The NRA is then required to assess the impact of such voluntary separation and change, withdraw or maintain regulatory obligations accordingly following the procedures set out in Articles 6 and 7 of the Framework Directive. For that purpose, the NRA will conduct a coordinated analysis of all the different markets related to the access network in accordance with the procedure set out in Article 16 of the Framework Directive.

According to the provisions of Article 13b, the communication of the intended transaction may lead NRAs to modify existing regulation accordingly while the rule doesn’t specify whether NRAs may affect the project notified by the SMP operator or not. In any case, it is possible that the assessment of NRAs may lead the SMP operator to modify its project of separation before the conclusion of the market analysis and thus before any modification of existing regulation.

¹⁰ Nevertheless, such measure could in principle be imposed under competition law instruments. Indeed, Council Regulation (EC) No 1/2003 permits the break-up of a company found to have infringed competition law, if it can be shown that no alternative behavioural remedy is equally effective. As a reference, see Council Regulation on the implementation of the rules on competition laid down in Articles 81 and 82 (now Articles 101 and 102) of the Treaty (EC) No 1/2003 of 16 December 2002: http://eurlex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=Regulation&an_doc=2003&nu_doc=1.

Article 13b states that “*Undertakings shall also inform the national regulatory authority of any change of that intent [...]*”. The decision to change the original intent might depend on different reasons and could also be affected by the opinions expressed by NRAs. For instance, it might happen that the SMP operator, on the basis of the outcome of the draft coordinated analysis of the access markets put under public consultation by the NRA, may decide to modify and/or adjust the intended transaction in order to lead the NRA to impose a lighter regulation or to deregulate the markets involved. This situation would be particularly likely to happen when the draft analysis put under consultation contains an unfavourable assessment by the NRA of the voluntary measure which does not give rise to any appreciable modification of existing obligations. A frequent interaction between the NRA and the SMP operator during the market analysis that follows the notification of the intention to separate the access network should ensure a smooth communication process which could facilitate the assessment of the measure by the NRA.

In Italy, for instance, national law allows the regulator to directly affect commitments proposed by operators. In fact, in case commitments are considered unsuitable to improve the conditions of competition through appropriate and stable measures, the regulator can ask the operator to modify its proposal on the basis of its suggestions. AGCOM used this power when assessing Telecom Italia’s voluntary commitments, which included a form of operational separation (see Annex I)¹¹.

As for the elements that have to be taken into account by NRAs in order to assess the intended transaction, Article 13b does not include specific provisions, the only guidance being the need to assess its impact on the existing regulation. The NRA action in the case of voluntary separation will be limited to conducting a coordinated analysis of the markets related to the access network in order to decide whether new remedies should be imposed or whether the remedies already in place should be maintained, amended or withdrawn accordingly.

It is reasonable to assume that NRAs need to assess the effect that the proposed transaction will have on competition in access markets and in ensuring equal treatment in the provision of access network services. NRAs could assess the intended transaction by means of the standard tools of market analysis, and analyse the content of the voluntary measure in parallel with existing remedies. While Article 13b does not grant NRAs powers to modify the transaction, it is worth noting that the separated entity may be subject to the specific obligations in Article 9 to 13.

It has to be noted that Article 13b(1) provides that the undertaking has to inform the NRA in case it intends “*to transfer their local network assets or a substantial part thereof to a separate legal entity*”. Therefore, a relevant issue to consider is how NRAs should measure the “*substantial part*” of local network assets (for example, by means of the number of local lines).

2.2.3. Timing of the communication and procedure

Article 13b provides that SMP operators inform NRAs “*in advance and in a timely manner, in order to allow the national regulatory authority to assess the effect of the intended transaction [...]*”.

¹¹ After the market test, AGCOM, while recognising that the new Telecom Italia’s proposal contained many improvements, deemed it not fully satisfactory and asked Telecom Italia to emend and integrate it (in five areas, some of them suggested by alternative operators during the market test phase) within 10 days. Consequently, Telecom Italia offered a final proposal which was deemed satisfactory by AGCOM, that approved and made it binding with Resolution n. 718/08/CONS.

The text of Article 13b implies that, following the communication of the intended transaction, the NRA should start its assessment by means of a coordinated analysis of all access markets involved to be conducted according to the procedure set out in Article 16 of the Framework Directive.

In this respect, the steps of a possible process can be outlined as follows.

- The SMP operator should communicate to the NRA its intention to adopt a voluntary measure within a reasonable period of time in order to give the NRA enough time to evaluate the intended transaction.
- The NRA could carry out a preliminary assessment of the communication received aimed at avoiding that the SMP operator presents a voluntary separation plan that is manifestly unreasonable, which would require the NRA to start its activities uselessly. This first screening could assess the reliability/seriousness of the intended transaction and its suitability to improve the conditions of competition in the sector.
- The NRA should begin the coordinated market analysis of all access markets involved only in the event that the preliminary assessment is favourable. To this aim, the SMP operator could be required to provide additional information and details.
- It might happen that the intended transaction is notified while the NRA is conducting an analysis of one or more access markets. In this case, it seems appropriate, in order to avoid any delay and to properly assess the measure, for the NRA to start evaluating the transaction within the context of the analysis already started and eventually to extend it to all other access markets involved.
- In order to fully assess the intended transaction, the NRA may need to acquire the comments of all interested stakeholders also by means of public hearings. For this purpose, the NRA could submit the intended transaction to an *ad hoc* public consultation during the market analysis as occurred in Italy and UK (see Annex I). Otherwise the intended transaction and its evaluation could be included in the draft access market analysis under consultation.
- Following the public consultation phase – where needed – the SMP operator may decide to modify its plans in light of the public consultation outcomes and the suggestions the NRA may have given. It is also possible that the incumbent – in any phase of the process – may decide to modify or withdraw the proposal for different reasons. In any event, the NRA should be promptly informed and where a modification is proposed, full details should be provided.
- Finally, when the planned transaction has been assessed, the NRA, following the procedures set out in Articles 6 and 7 of the Framework Directive, shall decide whether existing remedies should be maintained, modified or withdrawn and new obligations imposed. If market remedies change, the NRA should notify to the European Commission the measures to be adopted.

As NRAs may decide to modify existing obligations in light of the intended transaction, a proper degree of certainty about the implementation of the intended measure should be guaranteed. There is a need to avoid a risk of the transaction not proceeding after the modifications have come into effect. One of the possible solutions could be to condition the modification of the existing remedies to the implementation of the transaction (as a condition precedent/suspensive).

2.2.4. Interaction with the Commission

NRAs shall inform the Commission about the intended separation during the market analysis phase by means of the usual notification procedure, under Article 7 of the

Framework Directive, of the draft measure containing the assessment of the voluntary separation in case it impacts on existing remedies.

As suggested in the comments letter on the Italian case n. 987/988/989 (remedies on markets 1, 4 and 5) – which is the only experience so far on this topic – NRAs should notify the voluntary measures to the Commission only if they *i)* constitute, *ii)* directly relate to or *iii)* are ancillary to remedies.

In the abovementioned letter the Commission has expressed its view that when voluntary commitments impact over existing remedies, they fall within the scope of Article 7 of the Framework Directive and shall be notified and put under consultation. The impact on remedies shall be evaluated by means of the coordinated analysis, as in Article 13b.

In any case, as all EU experiences of voluntary separation can testify, NRAs may keep a frequent interaction with the Commission's offices (for example, through pre-notification meetings) in order to avoid difficulties in the following procedural phases.

2.2.5. Possible re-integration of the formerly separated entities

A further issue is related to the procedure to be followed in case the SMP operator, after having implemented a form of voluntary separation, takes a decision that would affect the existing commitments. This could be, for example, a re-organisation of the SMP operator's access network or even a decision to fully re-integrate back its local access entity. Article 13b does not contain any provision in this regard.

In any case, and depending on the nature of the variations, as voluntary separation of the access network is a measure which is very likely to affect the final decision on regulatory obligations, it appears that NRAs would need to undertake a new analysis of the affected markets, especially in the case of re-integration of the formerly separated entity.

In Italy, the SMP operator committed itself to inform AGCOM of any modification and/or re-arrangement of its internal departments that has a significant impact on the commitments; in this case, the SMP operator needs AGCOM's explicit approval.