

**Telecom Italia's contribution to the BEREC's Public
Consultation on:
*"Draft BEREC Guidance on functional separation under
articles 13a and 13b of the revised Access Directive and
national experiences"*.**

19th November 2010

1. Introduction

Telecom Italia welcomes the possibility to participate to the public consultation issued by BEREC on the “Guidance on Functional Separation”. We believe that the document submitted for public consultation and the annex on some selected national cases of implementation, depicts in a complete manner the wide range of topics and problems that a NRA could face in the case of enforcement of both mandatory and voluntary separation.

However, Telecom Italia would like to submit to BEREC’s attention three issues that should be analysed in deeper detail.

First, we suggest revising the taxonomy of Separation as proposed by Prof. Cave for the degrees 3 and 4. The current experiences in the field of Separation in several European Countries, demonstrate that a clear division between these two levels is very difficult: the granularity of tools and implementing measures needed to put in practice the Separation make preferable a classification having a single level under the label of “Functional Separation”. In addition we suggest also to introduce an evaluation of the effectiveness of the Functional Separation through a comparison of the measures in force.

Second, Telecom Italia points out the risk of a “double standard” outcome of the current regulation laid down by articles 13a and 13b of the Recommendation. If we consider the mandatory Separation provided by article 13a, the “exceptional measures” that can be imposed on an operator are considered as non standard “remedies”. Differently, if we consider the voluntary Separation provided by article 13b, the commitments submitted (voluntarily) by an Operator are considered only as “ancillary” measures to existing remedies. For these reasons we propose to adopt a unique regulatory evaluation for both mandatory functional separation and voluntary separation.

Third, we submit to the consultation some clarifications concerning the Italian experience on Separation described in Annex I.

2. The taxonomy of Separation and its effectiveness

We appreciate the classification of the degrees of Separation made by Prof. Cave since it represents an important contribution to the understanding of this matter.

However, Telecom Italia believes that BEREC should establish its own taxonomy, on the grounds of Cave’s proposal.

In fact, the current European experiences concerning Separation, point out the existence of a great variety of functional/operational models.

As noted also by other authors¹, the implementation of the Separation involves a variety of operational measures so that it will be difficult to classify exactly a specific model: BEREC

¹ Crandall et al., page 8 “functional separation involves several granular decisions about how the separated firm is to operate, e.g. who is to report to whom, (governance)”

itself states that the Italian model ranges between the 3^d and 4th degree of Cave's taxonomy of Separation.

Accordingly, we invite BEREC to revise the classification proposed by Prof. Cave by joining together the levels 3 and 4 into a single degree (the Functional Separation) as shown in the following new classification of the degrees of separation:

<i>Degree</i>	<i>Separation Option</i>	<i>Description</i>
6	Ownership separation	As 5 but with different ownership.
5	Legal separation	As 4 but with a separate non-executive board.
4	Functional separation	Different managers' incentives and different governance. Physical separation of businesses and new business practices, e.g. new office location, new brand, separate OSS, separate management info systems.
3	Virtual separation	First form of equivalence of access as internal and external customers are treated equally. No physical separation of the businesses.
2	Wholesale division	The incumbent has a separate wholesale division which supplies upstream inputs to competitors. The retail branch still has a preferential way to access products. No equivalence of access.
1	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.

As regards Functional Separation, Telecom Italia deems that it is not sufficient to focus only on one "driver" i.e. the legal status of the separate unit.

In particular, from the operational point of view, as noted by Crandall, the Functional Separation requires a set of tools and measures of control covering several aspects: the structure and number of KPIs, the Code of conduct, the measurement of incentives and the composition of the Board of control.

These measures are summarised in art. 13a which provides for 6 requirements that a mandatory separation must comply with, namely: (i) the definition of the legal status of the unit; (ii) the identification of assets; (iii) the governance arrangements; (iv) the rules of compliance; (v) the rules for transparency; (vi) the monitoring programme.

Accordingly, we propose to introduce a number of criteria aimed at a careful evaluation of the effectiveness of the different Functional Separation models on the basis of the criteria of art. 13a.

A non exhaustive list of items to be evaluated and measured could include:

- Services under the rule of Separation (only copper network, both copper network and NGAN).
- Separation of staff and managers (separation of premises), Code of Conduct and Incentive System for the personnel of the separated unit.
- Separation of System and “Chinese walls”. Rules to verify the separateness (internal/external auditor).
- Technical Equivalence Rule:
 - o SMP services monitoring system (KPIs)
 - Areas of KPIs (delivery, assurance, system and service availability).
 - o Monitoring System transparency
 - Rules of certification and independence of the audit of KPIs.
- Transparency in the openness of information toward third parties: publication of Network Quality, Technical Plans and Network Development Plans;
- Economic Equivalence:
 - o Regulatory accounting, transfer charges and internal contacts.
- Board of Control (governance): composition and powers to enforce compliance, powers of investigation, independence.

3. The risk of a double standard in the classification of remedies

With regard to paragraph 2.2.4 “Interaction with the Commission”, Telecom Italia would like to point out a relevant aspect for the analysis.

The procedure envisaged according to art. 13a (mandatory separation) provides that when a NRA finds that the remedies under art. 9 to 13 of the Access Directive (AD) are not sufficient to redress the competitive situation, it can impose the Separation as an “exceptional measure”.

Art. 8.3 AD gives to the Commission a prominent role of safeguard and control to avoid the imposition of any undue burden on the undertaking concerned.

Any measure related to the implementation of the Functional Separation imposed by the Regulator to the Operator must comply with art. 13a and thus becomes an “exceptional remedy”.

Differently, the set of commitments proposed by an Operator in case of voluntary separation, are subject to the requirements of art. 13b. Telecom Italia is concerned with the regulatory treatment given to the voluntary separation commitments.

In the aforementioned paragraph 2.2.4, it is reported that, according to the comments letter on the Italian cases no. 987/988/989, “NRAs should notify the voluntary measures to the Commission only if they i) constitute, ii) directly relate to or iii) are ancillary to remedies”.

Telecom Italia does not consider appropriate the approach to establish only a link between voluntary separation commitments and the existing remedies. In fact, such an approach neglects that the voluntary separation commitments may fall, and indeed this is the case for Functional Separation, outside the scope of the standard remedies.

Telecom Italia believes that when the commitments are fully consistent with the provisions of art. 13a, they should be always considered as “exceptional measures” and thus transposed into “exceptional remedies” (that is to say into a non standard category of remedies).

This should avoid that a same set of separation rules receives a different status according to different circumstances, i.e. whether they are the outcome of a mandated functional separation or the outcome of a voluntary separation.

Moreover, the equal treatment of the separation remedies for both voluntary and mandatory separation will give certainty to the regulatory framework.

Telecom Italia invites BEREC to revise accordingly the guidance given in section 2.2.4.

4. Notes on the Italian experience on Separation

Telecom Italia appreciates the complete and exhaustive description of the Italian national experience on Functional Separation.

We would like to submit some clarifications aimed to give few more details on Telecom Italia's model.

In the first section “**Context and legal basis**” the description of all the legal instruments used in the Italian case is complete and exhaustive. Nevertheless we would like to point out that Telecom Italia created Open Access in February 2008, as a “separate” entity from the retail operations with its own staff, information systems and investment budget, in charge of producing, delivering and managing wholesale SMP access services.

In the section “**Degrees of separation**” we would like to give more emphasis both on the issue of the role of KPIs in ensuring the technical equivalence and the wholesale services pricing rules established by Agcom according to the principle of equality of treatment. Concerning the KPIs, Open Access receives orders for access network services from both TI Wholesale (which continues to be the “one-stop-shop” for alternative operators) and TI Retail. The equality of treatment is ensured by means of several KPIs submitted to Agcom and AltNets according to the Undertakings 3 and 4. Concerning the pricing rules, according to the principle of the equality of treatment, it is important to highlight that paragraph 67 of the Agcom Decision 731/09/CONS, states that TI Wholesale costs must be attributed also to TI even if TI Wholesale is the “one-stop-shop” only for the alternative operators.

In the section “**Model of equivalence/Consumption models**” Telecom Italia points out that the model implemented in Italy works by means of 4 main “pillars” of the Functional Separation. Open Access has the commitments to guarantee both **technical and economic equal treatment** to AltNets and the Retail operations of Telecom Italia. The approach to Functional Separation is based on the criteria of (1) Technical Equivalence; (2) Economic Equivalence; (3) Separation; (4) Transparency.

In particular, these criteria are implemented as shown as follows:

1. **Technical Equivalence**, granted by the Equivalence of Outcomes (same SMP wholesale access services provided to AltNets and TI Retail), the Equivalence of Processes (delivery and assurance processes comparable) and a clear definition of KPIs to monitor the effectiveness of the Equivalence.
2. **Economic Equivalence**: obtained through: a) Internal Agreements; b) definition of Internal Transfer Price Models, from the certified Regulatory Accounts; c) Separation of Accounts between SMP wholesale access services provided.
3. **Access Separation**: it is ensured with the institution of the “Open Access” and “Wholesale” Separated Functions and the definition and publication of a Code of Conduct for the Employees. The separateness of roles for the personnel is reinforced by a specific training and an Incentive Scheme. The information systems of the technical and retail functions are separated by a Chinese wall certified by an external independent body.
4. **Transparency**: the goal of transparency is obtained through the publication of the Quality and Development Plan and Programmes for the access network, including the NGANs. The Altnets have the accessibility to the Technical data of Open Access. Finally the KPIs regarding the Assurance and the Delivery are published with regard to both the performances for Altnets and TI Retail.

Moreover, to spread within the company a “culture of equivalence” is the basement of the model.