COMMENTS ON DRAFT BEREC GUIDANCE ON FUNCTIONAL SEPARATION UNDER ARTICLES 13A AND 13B OF THE REVISED ACCESS DIRECTIVE AND NATIONAL EXPERIENCES

Submission by PT (Portugal Telecom) Group

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1. GENERAL REMARKS

Portugal Telecom Group (hereinafter PT) would like to begin its submission paper by welcoming the public consultation launched by the Body of European Regulators for Electronic Communications (hereinafter BEREC) on functional separation. We believe that all communications, guidelines and other documents that may have impact on the market and on industry stakeholders should be subject to a transparent and thorough consultation process.

Moreover, considering the purpose of BEREC document, *i.e.*, to devise guidelines for applying functional separation, we reckon that the decision of launching a public consultation is entirely justified and industry stakeholders should have (and will certainly have) a significant role on this matter. Hence, we welcome the opportunity to participate in this consultation and to put forward some comments on functional separation that we are confident will be taken into consideration by BEREC when drafting the final version of the future guidelines.

We would like to start our general remarks by stressing that, during the discussion of the Revised Regulatory Package, PT has opposed the idea of considering functional separation as a possible remedy. We still maintain this position.

Functional separation is an extremely intrusive measure, with a very strong impact on operators' activities and with negative consequences on investment strategies. At the same time, there are indicators that functional separation is costly and has not produced the expected results[1].

A number of analyses have shown the tremendous operational costs and capital expenditure required for implementing functional separation. Even ARCEP recognized that functional separation would not act as an effective and proportionate measure in view of the costs involved. As it is generally recognized, these relate to the reorganisation of the company, the duplication of technical staff and engineers, the splitting up of various activities which benefited from synergies, the loss of economies of scale and scope the costs on information technology systems, amongst others. BEREC will certainly acknowledge that

[1] Several consultants challenged the relationship between functional separation and the reported "*improvements in the performance of the UK fixed telecoms market – and in particular, the level of local loop unbundling (LLU)*".

much of these costs represent a pure "deadweight loss" for the operator concerned and will be reflected on prices for the services involved.

Moreover, this remedy does not seem to make much sense in a Revised Regulatory Package where promoting efficient investment and infrastructure based competition are key policy objectives. Functional separation will cause considerable prejudice to the industry and to consumers by compromising investment in fibre optic access networks.

However, as the Regulatory Package has been approved and published and functional separation is a non-standard remedy available for National Regulatory Authorities (hereinafter NRA(s)) in exceptional circumstances, PT would like to state that does not oppose *per se* to the idea of defining guiding principles that should be considered when making a case for applying this measure. In fact, we recognize that such guidelines are an important tool in the event NRAs decide for functional separation. In addition, defining a concise set of practicable rules could contribute to the development of the internal market and to a more consistent and predictable regulatory approach throughout the European Union.

Given the special nature of functional separation and the negative consequences of its imposition, we are certain that this objective should be addressed with extreme caution and thus the guidelines to be devised must not overlook the singular characteristics of this measure. On the other hand, care must be taken to ensure that such guidelines do not end up in a "one size fits all" regulation, making it hard for NRAs to take in due consideration national specificities.

In this context, under no circumstances should the future guidelines create procedures that bypass or disregard the provisions and rules laid down in Article 13a of Directive 2002/19/EC, of 7 March 2002, as amended by Directive 2009/140/EC, of 25 November 2009 (hereinafter Access Directive). Such provisions and the context around functional separation[2] have shaped this remedy as an exceptional, extreme, non-standard, highly intrusive and non-reversible regulatory measure. PT is confident that the future guidelines will reflect these features and will pay close attention to the elements set forth in the Access Directive.

[2] During the revision of the Regulatory Package, several entities expressed some concerns on functional separation as a regulatory measure as well as on the requirements that shall be fulfilled in order to determine its imposition. Agreement on this matter was not easily obtained and functional separation still remains one of the most questionable aspects of the Revised Regulatory Package.

In fact, functional separation is deemed as a measure of last resort that must not be applied without the fulfilment of all steps and criteria laid down in the Access Directive. We trust that BEREC will recognize during its works that the complexity of the procedure defined in the Access Directive deliberately placed on NRAs an «aggravated burden of proof», which must be fully satisfied when justifying the necessity of this remedy.

We believe that BEREC should also recognize that the requirements for imposing functional separation are much more burdensome and demanding in this case than in the case of any other regulatory measure. This has been intentionally provided for in Article 13a of the Access Directive. Furthermore, the application scope of functional separation has been narrowed, so that this measure can only be imposed in extreme and exceptional circumstances, clearly evidenced by empirical and economic reasons and based on a cost-benefit analysis.

Such conditions apply to any type of separation and thus this measure, whatever its content and shape is, must always abide by the procedures and rules set forth in the Access Directive. PT strongly believes that the principle of Equivalence of Access (EoA) — which is at the core of functional separation — may only be pursued with respect of all those requirements. For that reason, PT considers that BEREC should clearly state in its draft guidelines that the steps in Article 13a of the Access Directive should always be complied with, regardless of the type of separation to be imposed.

A strong effort should be made so that the future guidelines do not streamline or circumvent the requirements for applying functional separation and do not unjustifiably broaden its application scope. PT must stress that some aspects of BEREC document unwittingly seek to facilitate the imposition of this measure and are not in line with the rules set forth in the Access Directive.

On this matter, and without prejudice to the comments below, PT would like to draw BEREC's attention to the following aspects.

First, it is noteworthy that BEREC guidance on structural barriers and competition problems fails to reflect the special nature of functional separation. In fact, the examples provided by BEREC could be properly dealt with using the standard tools of the Regulatory Package — namely the obligations of non-discrimination and transparency — and do not justify such an intrusive and extreme measure as functional separation.

One could be led to think that BEREC takes the view that behavioural problems, namely discriminatory conduct, correspond to the type of reasons that could trigger the application of functional separation. However, PT believes that this measure, as it is formulated in the Access Directive, implies a failure of the overall regulatory framework and a complete absence of competition in the market. It is clear that behavioural problems could be suitably (and much more adequately) addressed using the appropriate standard tools already available.

PT considers that BEREC guidance on this matter must be more comprehensive and should point out examples of structural barriers and competition problems that are attributable to the operator with Significant Market Power (SMP); failures that are not suitably dealt with using the menu of standard remedies, as a result of a relevant market analysis.

PT would also welcome the adoption by BEREC of a better view of the principles of technological and service neutrality. When intending to apply functional separation, NRAs must assess the prospect of competition in all access platforms. Also, NRAs should consider the entire market and not only users of wholesale access products from the incumbent.

In addition, we regrettably noted that most of BEREC guidance concerns the reasons that *may justify* the imposition of functional separation. The document does not address the conditions that should lead to the inverse conclusion, *i.e.*, that functional separation should not be applied.

For instance, it has been recognized by many stakeholders and even some NRAs that when platform competition exists, in particular due to the presence of a national and capillary cable network, functional separation is not necessary. We thus consider that BEREC document should not be focused only on the conditions that may justify the imposition of functional separation, but also on aspects that should prevent this measure from being applied.

In PT's opinion, the existence of infrastructure competition is one of the various reasons that should lead BEREC to advice that the requirements for imposing functional separation are not fulfilled and thus this measure should not be applied. We note that infrastructure competition is gaining increased importance as most operators are upgrading their networks to Next Generation Networks (NGN) or are deploying new high-bandwidth networks.

In Portugal, due to the presence of a nation-wide cable network, capable of offering high-speed services, we are certain that the conditions for imposition functional separation, in particular the provision in Article 13a/2 (b) of the Access Directive, are not satisfied and thus the Portuguese NRA (ANACOM) may not resort to this measure without violating the requirements defined in the Directives. In fact, Portugal has a strong platform competition and infrastructure rivalry is expected to boost in the sort/medium-term as several operators are installing new high bandwidth networks, including in remote areas, where the Portuguese government launched 5 public tenders in order to promote investment in NGN.

In addition, the Portuguese legal framework (in terms of general laws[3] and reference offers[4]) contains the necessary provisions in order to ensure that there is the same level playing field when it comes to investment decisions on NGNs. The Portuguese NRA (ANACOM) acknowledged the increase on competition, when it decided to deregulate the broadband access market in some areas of the Portuguese territory.

That being so, we believe that the imposition of functional separation in Portugal is pointless and would only hamper investment, innovation and platform competition, which should be guiding objectives of the regulatory policy.

It is worth noting that in 2008 ANACOM engaged an independent consulter (Oxera) to carry out a detailed analysis of the appropriateness of functional separation in the national market. The final report from July clearly points out to a negative conclusion, underlining that several indicators in Portugal provided strong evidence of the competitive conditions in Portugal and that there was a significant level of infrastructure competition.

Summing up, in PT's view the draft guidelines should be revised so as to add depth and rigour to some aspects and to ensure that the procedures and rules established in the Access Directive are duly respected, providing clear guidance that when infrastructure competition exists, or is likely to exist within a reasonable time-frame, the requirements in Revised Regulatory Package are not satisfied and NRAs may not impose functional separation.

[3] Decree-Law n. 123/2009, of 21 May 2009, eliminate horizontal and vertical barriers to the deployment of new electronic communication networks by, among other measures, imposing a general access obligation on any undertaking which manages telecommunication infra-structures.
[4] Since 2006 PT is offering access on regulated conditions to its ducts.

2. SPECIFIC COMMENTS

Below we offer some comments and raise some concerns regarding Section 2 of the draft guidelines — "Guidance on Functional Separation in the Revised Framework (Articles 13a and 13b of the Access Directive)". We will distinguish our submissions in accordance with the proposed structure. In 2.1. we will comment BEREC's guidance on mandatory separation and in 2.2. we will make some remarks concerning voluntary separation.

In general terms, PT agrees with the statement made by BEREC (cf. p. 5) that the future guidelines are 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*.

Given the special nature of functional separation, it should be clear that even if all indicators set out in the future guidelines are fulfilled, this would not be enough to determine the imposition of this rule. What is really important is that the procedure and rules defined in the Access Directive are always strictly followed, taking due account of the specific circumstances of national markets. As rightly mentioned by BEREC (cf. p. 12), "*the final decision will therefore be the result of a national analysis that takes due account of the specificities of the national markets.*"

Therefore, it should be made clear that NRAs are not supposed to look upon the future guidelines as a list of criteria whose fulfilment automatically triggers the application of functional separation. On the contrary, NRAs will have to comply with the highly demanding and complex burden of proof that has been deliberately placed over them by the European legislator.

We believe that BEREC should emphasize that the mere fulfilment of a list of indicators will not be sufficient to respect the level of evidence and assessment required by the Access Directive. In PT's opinion, a different understanding would deeply disregard the very special characteristics of functional separation.

2.1. COMMENTS ON FUNCTIONAL SEPARATION AS A NON-STANDARD REMEDY

2.1.1. Meaning of functional separation

In this sub-section we would like to focus our attention on the statement made in p. 8 of the draft guidelines, where BEREC confirms that "*the overall purpose of the functional separation, no matter what form is chosen, is to ensure full 'Equivalence of Access'*." We note that according to Article 13a of the Access Directive, the principle of Equivalence of Access is at the core of functional separation.

This has several consequences that BEREC should recognize and assume during its works, bearing in mind that functional separation, even in the form of Equivalence of Inputs (EoI) or in Equivalence of Outputs (EoO), shall not be pursued without considering the requirements established for this measure in the Revised Regulatory Package. The principle of Equivalence of Access is not an end in itself, but the final objective of functional separation.

PT considers that any action purporting to impose Equivalence of Access will have to be made within the legal framework established for the imposition of functional separation. The future guidelines should be utterly clear on this matter.

2.1.2. Exceptionality of the measure

According to BEREC, "*the exceptional nature of the remedy, in particular the difficulty of reversing it once imposed, 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*" (cf. p. 8).

The historical context that led to its approval and the provisions shaping this measure in the Revised Regulatory Package, namely in the Access Directive, show without doubt that functional separation is an exceptional, non-standard, highly intrusive and difficult-to-reverse measure. We welcome the fact that BEREC has correctly identified the main characteristics of this remedy.

The *exceptionality of functional separation* is made clear by the fact that it is a measure of last resort. According to Recital 61 of Directive 2009/140/EC, functional separation shall only be justified in exceptional cases *where there has been* ***persistent failure*** *to achieve effective non-discrimination (…) 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).

We support BEREC's position stating that functional separation should only be applied when there is a substantive reasoning concluding that all other standard obligations have consistently failed to cure market failures within a reasonable time-frame. (cf. p. 9). In this case, a NRA intending to impose this ultimate obligation shall have to bring forth conclusive evidences showing that functional separation is truly the only measure that may help to alleviate the persistent competitive problems detected in the market.

It follows from here that functional separation should only be applied when all standard remedies have been correctly applied and consistently enforced and still the competitive problems have not been solved or minimized. In addition, functional separation should only be applied when special market circumstances and evidences of market failures are collected, examined and presented to industry stakeholders.

Although BEREC supports this idea in p. 10[5] of the draft guidelines, PT would call on BEREC to be more assertive in this matter. Considering the nature of functional separation, it should be emphasized that if there is the slightest possibility to correct a market failure by using some standard remedy or by strengthening its application, the requirements for imposing functional separation will not be fulfilled and NRAs should forbear from applying it.

Functional separation is also a non-standard remedy in the sense that its approval depends on a specific authorization process that involves the intervention of BEREC, COCOM and the Commission (cf. Article 8/3 of the Access Directive). Different from standard remedies, Article 13a dictates a number of requirements that have to be considered when assessing the imposition of functional separation. Finally, the Commission has veto power over the draft notifications made by NRAs, which does not exist in other remedies.

[5] When it refers that "*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.*"

In PT's opinion, the complexity and strictness of this procedure has deliberately placed on NRAs an «aggravated burden of proof» that needs to be fulfilled when justifying the necessity of functional separation. In addition, this procedure also highlights the negative consequences of functional separation for the operator concerned and also on the market as a whole, thus the corrective powers granted to the Commission on this matter.

PT would also like to comment that it is unlikely that the specific characteristics of functional separation are compatible with the time-frame indicated in Article 16/6 of Directive 2002/21/EC, of 7 March 2002, as amended by Directive 2009/140/EC (hereinafter "Framework Directive"). This provision allows a NRA to keep a market analysis unchanged for 6 years (provided that it is authorized by the Commission for a 3 year's extension after the first 3 year's period).

Instead of simply referring to this provision[6], PT would endorse a recommendation by BEREC to NRAs to revise any decision implementing functional separation within, at least, the first period of 3 years, *i.e.*, without using the possibility to extend this deadline for more 3 years. We believe that the special nature of this measure and the (negative) impact that will have on the market requires a coordinated keep-to-date analysis, eliminating any measures that may constrain the competitive capacity of an operator and that are detrimental to investment decisions.

In fact, when functional separation is imposed, its effects on the market shall be constantly measured and NRAs must ensure that any regulatory obligation deemed unjustifiable is quickly eliminated. PT strongly believes that functional separation is not compatible with a market analysis that endures for several years before being revised in order to eliminate regulatory obligations.

Finally, *functional separation is a highly intrusive and non-reversible measure*. It is generally assumed that this remedy has very high costs and it is a process that could take a significant amount of time in order to be implemented. Due to the type of structural and operational changes needed to put this remedy into practice, it is almost impossible to reverse it once it is imposed. This characteristic of functional separation emphasizes again its exceptionality and the importance that the possible benefits arising from its application clearly outnumber the damage caused by it.

[6] BEREC states in p. 9 that "*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*".

All these features result very clear from the provisions in the Access Directive and BEREC correctly recognizes them. Therefore, PT considers that the guidelines must reflect the particular characteristics of this measure and a strong effort should be made so as to ensure that any practical advice does not bypass the requirements laid down in the Access Directive. We also believe that it is important to recognize that the level of requirements for imposing functional separation is much more burdensome and demanding than in other regulatory measures. This has been intentionally provided for in the rules of Article 13a of the Access Directive.

2.1.3. Procedures

As regards the indications in pp. 10-12 of the draft guidelines, PT would like to comment the following.

First, as regards the market analysis procedure, PT considers that any form of functional separation shall only be applied following a thorough market analysis. Such assessment should pay close attention to the characteristics of the national market and should consider the elements provided for in the Commission Recommendation 2007/879/EC, of 29 December 2007, namely the principle that regulation should only be imposed when there are market failures to address.

In addition, as in all regulatory remedies, functional separation is not an end in itself and may not justify a market analysis *per se*. In other words, NRAs should not initiate a market analysis with the view to impose functional separation. This would distort the assessment. Functional separation shall only be applied after a market and SMP analysis and its imposition will always depend on the conclusions reached, namely that the standard regulatory tools are deemed to be ineffective to solve the identified market failures.

Moreover, PT notes that the draft guidelines do not specifically address the issue of defining sub-national markets. Considering that market analysis must be strongly geared to geographic segmentations approaches, it would be very important to consider if it makes sense or if it is feasible to apply functional separation where markets have been geographically segmented. It is PT's opinion that functional separation does not make sense in a case where a market has been split due to different competitive conditions, that is, where NRAs have already recognized that infrastructure competition exists in a sufficient manner

in order to justify the geographical segmentation. In our view, BEREC should be more explicit on this matter in the future guidelines.

Second, although Article 13a of the Access Directive is silent on whether the proposal and the draft measure should be submitted jointly to the Commission, PT respectfully disagrees with BEREC's statement that the *proposal has a complementary nature* (cf. p. 11). This position does not seem to be in line with the requirements of the Access Directive and a NRA could interpret it as if the "proposal" was dispensable and only the draft measure was necessary.

The "proposal" to be submitted to the Commission is the document that really reflects the exceptional nature of functional separation and it is vital to justify the imposition of this measure. In PT's view, BEREC should revise this part of the draft guidelines so as to make clear that the "proposal" must always be submitted to the Commission and that must comply with the requirements laid down in the Directives. PT also believes that the "proposal" should be an independent document from the draft measure, so as to have the importance that the European legislator intended for it.

Third, regarding the coordinated analysis stage and imposition of remedies in affected markets, BEREC's interpretation of Article 13a/4 of the Access Directive is that the coordinated analysis should take place *after* the imposition of functional separation, within a time-frame not expressly stated[7]. We do not believe that this is the best interpretation of this provision.

In fact, Article 13a/4 does not determine if the coordinated analysis should take place after or before the imposition (*i.e.*, final decision) of functional separation. Formally, it only states 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 in accordance with the procedure set out in Article 16 of Directive 2002/21/EC*".

Considering the vague terms of this provision, we are not sure if the intention of the European legislator was to (i) postpone the coordinated analysis to a moment subsequent to

[7] In fact, in p. 12, BEREC mentions that "*the Directive is silent on the time-frame for this* [the coordinated analysis] ***and it would be reasonable to allow some time for the imposed measure of functional separation to have an effect***". This last part shows BEREC's position that the coordinated analysis should take place after the imposition of functional separation.

the imposition of functional separation or (ii) coordinate the imposition of functional separation with the revision of the different markets related to the access network.

From a regulatory policy perspective and bearing in mind that market analysis should always be forward-looking we believe that option (ii) is the most adequate and thus BEREC's position should be revised on this matter.

Even if we accept that the coordinated analysis should take place at a later stage following the imposition of functional separation, BEREC's position as regards the time-frame for conducting such analysis is not very clear and could be better substantiated. As BEREC mentions, the purpose of the coordinated analysis is to assess if the existing regulatory remedies need to be maintained, amended or withdrawn following the imposition of this measure. It is highly unlikely that this objective is respected if the coordinated analysis is not initiated within a short time-frame following the imposition of functional separation.

We note that the general reference that BEREC makes to Article 16 of the Framework Directive could mean that a NRA may take up to 3 years (in exceptional cases a maximum of 6) to reappraise its market analysis. PT believes that such time-frame is not compatible with the obligation to conduct a coordinate analysis established in Article 13a/4 of the Access Directive. We consider that BEREC should provide better guidance on this matter, suggesting a time-frame for carrying out a new assessment that is compatible with the nature and consequences of functional separation.

Therefore, PT urges BEREC to provide guidance on this time-frame so as to avoid market distortions resulting from the continued application of standard remedies in parallel with functional separation. The fact that the Access Directive is silent on this time-frame will most certainly lead NRAs to consider the deadlines established in Article 16/6 of the Framework Directive (3 years) and this does not adequately consider the huge (negative) impacts caused by functional separation.

Finally, we would like to note that Article 13a is silent on whether the "Proposal" and the "Draft Measure" should be subject to the consultation and transparency mechanism established in Article 6 of the Framework Directive. However, considering the impact of functional separation on the operator concerned and on the market as well, in our view, there is no doubt that interested parties shall have the opportunity to comment such documents within a reasonable period.

We believe that BEREC should state in the forthcoming guidelines that both the "Proposal" and the "Draft Measure" referred to in Article 13a of the Access Directive are subject to the consultation and transparency mechanism set out in the Framework Directive, ensuring that any confidential information are not disclosed. In PT's opinion there are no reasons that support a different understanding on this matter.

2.1.4. Contents of the proposal to the Commission

According to Article 13a/2 of the Access Directive, when a NRA intends to impose an obligation for functional separation, it shall submit a proposal to the Commission that shall include: (a) evidence justifying the conclusions of the national regulatory authority as referred to in Article 13a[8]; (b) a reasoned assessment that there is no or little prospect of effective and sustainable infrastructure-based competition within a reasonable time-frame; (c) an analysis of the expected impact on the regulatory authority, on the undertaking, in particular on the workforce of the separated undertaking and on the electronic communications sector as a whole, and on incentives to invest in a sector as a whole, (d) an analysis of the reasons justifying that this obligation would be the most efficient means to enforce remedies aimed at addressing the competition problems/markets failures identified.

The evidence to be made available in accordance with (a) above shall clearly demonstrate that:

- there are real competition problems and/or market failures and not only theoretical or alleged problems;
- the appropriate obligations have been effectively defined;
- their enforcement has been ineffective in addressing the competition problems and/or market failures, bearing in mind that a reasonable amount of time will need to pass between the imposition of such obligations and the reaching of this conclusion; and
- any remaining competition problems and/or market failures are important and persistent. It is important to stress that NRAs will have to show that competition problems are not only *important*, but they are also *persistent*. These are two cumulative

[8] 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.

requirements and only if and when both are fulfilled may functional separation be considered.

According to BEREC, the proposal to be submitted to the Commission has two main purposes: (i) to provide evidence concerning market and SMP analysis and (ii) to present an impact analysis of the imposition of functional separation on the market and on stakeholders. We will consider these aspects below.

2.1.4.1.Assessment of the need to impose functional separation

As regards this part of the draft guidelines, we believe that the guidance provided by BEREC is not sufficient and does not reflect the special nature of functional separation. It is important to emphasize that this is an exceptional measure, extremely intrusive, that shall only be applied as a remedy of last resort. BEREC should consider these characteristics when defining guiding principles that may lead a NRA to apply functional separation.

There are some examples that may be pointed out on this matter. For instance, Article 13a/2 (a) of the Access Directive determines that the proposal to be presented to the Commission must bring forward clear evidences that the *appropriate obligations imposed have failed to achieve effective competition*. However, when reading BEREC document, we find little or inexistent guidelines as per this matter. In fact, when should be considered that such standard remedies have failed? How should we understand the reference to *appropriate obligations* in Article 13a/2 (a)?

PT stresses that in some cases regulatory tools are not the appropriate tool to change the competitive landscape of a market and induce investment. There are several factors, such as demographic aspects, media literacy, purchasing power, etc., that contribute to shape competition in a market and that are independent of regulatory policies. In such situations, the imposition of new remedies will not help to solve competition problems, but will rather hamper competition and constitute an unfair and disproportionate burden on the operator(s) concerned. PT notes that BEREC does not refer any of these factors in its draft guidelines and this could be important so that NRAs make a better assessment of the competitive conditions of a relevant market.

Given the importance of this requirement when justifying the need of functional separation, we believe that a more rigorous analysis would be entirely justified.

Moreover, Article 13a/2 (a) also determines that NRAs should provide clear evidence that competition problems detected are *important* and *persistent*. Once again, we believe that BEREC document not only lacks detailed guidance on this matter but also seems to be creating misunderstandings on matters that should be solved by market analysis and by the application of standard and traditional remedies. We are referring here to BEREC's statements on structural barriers to entry and on the persistence of competition problems.

First, we must note that BEREC's references on the existence of structural barriers and the persistence of competition problems (cf. p. 14) fail to present criteria that go beyond the aspects that are typically considered by NRAs when defining and assessing a relevant market. In fact, the absence of alternative infrastructures, the persistence of bottlenecks and indicators such as (i) market shares and their trends over time (ii) persistent problems of discrimination and (iii) retail market structure are all aspects that must be considered by NRAs when conducting a market analysis.

In accordance with the rationale underlying Article 13a/2 (a) of the Access Directive, PT strongly believes that the imposition of functional separation requires the consideration of other criteria or at least a level of analysis that goes further than the traditional assessments made by NRAs. The draft guidelines of BEREC on this matter will most surely facilitate (in the sense that they bypass some steps required in the Directives) the imposition of functional separation when the principle in the Access Directive is that this is a remedy of last resort, suitable only in exceptional conditions.

In fact, if not modified, BEREC's guidelines will allow NRAs to impose functional separation without complying with the «aggravated burden of proof» that the European legislator intentionally placed over them. In fact, NRAs will feel that the standard market analysis (*i.e.,* the traditional assessment of competitive conditions in a relevant market and the SMP analysis) are sufficient to determine the imposition of functional separation, when the rules in the Access Directive requires NRAs to (i) deepen their level of analysis (especially on the application and enforcement of regulatory obligations), (ii) bring out a set of evidences that would not normally be necessary for imposing standard remedies and (iii) conduct a detailed impact assessment, showing in any case that functional separation is the only mean capable of addressing the detected market failures and that its benefits clearly surpass its negative consequences.

Therefore, PT calls on BEREC to modify this part of its guidelines so as to ensure that the future guidance will reflect the special nature of functional separation as well as the rules set forth in the Access Directive.

Also related with this part of the draft guidelines, one could be led to think that BEREC takes the view that behavioural problems, namely discriminatory conduct, correspond to the reasons that could trigger the application of functional separation[9]. However, PT believes that this measure — as it is formulated in the Access Directive — presupposes a regulatory failure and a complete absence of competition in the market. It is clear that behavioural problems could be suitably addressed using the standard regulatory tools already available.

BEREC is not clear about the meaning of structural barriers and its relation with SMP operators. Structural barriers are in general external to the behaviour of any operator and thus it is not entirely understandable how BEREC intends to link structural barriers with the statement that *persistent discriminatory practices may lead to the imposition of functional separation*. On the other hand, we note that standard remedies, when properly applied, solve the competition problems that BEREC refers, making functional separation a disproportionate measure to solve them.

Hence, PT believes that BEREC guidance on this matter must be more comprehensive and detailed[10]. If competitive problems are important and persistent, instead of simply bring forth functional separation, NRAs must first conduct a comprehensive assessment in order to determine the reasons that may justify such conclusion and to verify if the regulatory obligations are being properly applied and enforced. This assessment must always precede the imposition of functional separation.

Despite the foregoing comments, PT endorses BEREC's position (cf. p. 14) that when access to the incumbent's network is not essential, given that viable alternative infrastructures exist or could be foreseen, discriminatory practices may not be assumed to have such a relevant impact on the competitive conditions so as to justify imposing functional separation.

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[9] For instance, in p. 14, BEREC states that "*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*" (emphasis added).

[10] For instance, how can one consider the increase of disputes has an indicator of a competition problem? A dispute does not mean that it is attributable to the SMP operator or that this undertaking will be considered guilty at the end of the process.

However, PT would call on BEREC to build on this understanding so as to provide more guidance as per the requirement defined in Article 13a/2 (b) of the Access Directive. This provision determines that NRAs must provide evidence that there is little or no prospect at all of effective and sustainable infrastructure competition within a reasonable time-frame. PT's view is that where platform competition exists or it is likely to exist within a reasonable time-frame, functional separation should not be imposed. Even in cases where there is effective service competition it is questionable that functional separation should be considered.

In Portugal, for instance, we have a strong platform competition due to the presence of a national and very capillary cable network (hybrid fibre-coaxial, evolving towards all-fibre in some areas) being upgraded to offer high-speed services throughout the territory. In addition, the Portuguese NRA concluded in 2009 that in an important number of geographical areas no operator has SMP in the wholesale broadband market. PT strongly believes that these (or other similar) reasons should immediately prevent functional separation from being applied and this should be clearly stated in the future guidelines.

Moreover, we note that the draft guidelines do not deal with the massive deployment of NGNs throughout the European Union. As mentioned above, it is noteworthy that in Portugal several operators have been investing in the last years in high-bandwidth networks, making it plausible to assume that infrastructure competition will steadily increase in the forthcoming years, with the correspondence benefits to consumers' welfare and to the national economy as well. In addition, the upgrade and construction of these networks show that the incumbent's network is not essential and these new networks will create a competitive constraint that is not compatible with the imposition of functional separation.

Based on Article 13a/2 (b) of the Access Directive, NRAs must assess the prospect of competition in all access platforms. When carrying out this task, NRAs must therefore consider the entire market and not only users of wholesale access products from the incumbent. If the NRA finds that industry stakeholders are investing in these alternative platforms, then it cannot reach the conclusion that functional separation is necessary.

2.1.4.2.Assessment of the impact of imposing functional separation

As regards this part of the draft guidelines, PT agrees with BEREC when it states that "*given the risk of regulatory failure of a such difficult-to-reverse measure (…) the impact analysis that*

NRAs will have to undertake could become the most difficult aspect of the whole analysis". Although difficult, PT reckons that this evaluation is vital before deciding to impose functional separation.

Given the huge complexity and costs of functional separation and the likelihood of its negative impact on the market, it is indispensable that NRAs conduct a comprehensive and pragmatic (not theoretical) impact assessment. Only then could the requirement in Article 13a/2 (c) be deemed fulfilled.

As BEREC rightly states (cf. p. 12), this impact assessment is not required for standard remedies and thus NRAs must really go further on this matter, and may not rely on the long-established standard market analysis.

From the elements mentioned in Article 13a/2 (c) of the Access Directive, PT would like to focus its attention on the impact on the undertaking and the sector, on incentives to invest, and on competition.

As regards the *impact on the undertaking and the sector*, it is clear (and BEREC justifiably acknowledges it) that functional separation is a huge and complex process in legal, operational, economic and labour terms. The costs for its execution are also enormous. In addition, the time consumed for putting in place all changes required by this measure may not be suitable to tackle the competition failures that a NRA will have to evidence to apply functional separation, at least in the short-term. This constitutes an inconsistency between the sort of market failures that may justify the imposition of this remedy and the required time for executing all changes deemed necessary. From the undertaking's perspective, functional separation does not bring any advantage.

As for the sector, BEREC recognizes that the impact of functional separation on the electronic communications sector is very difficult to foresee. Conversely, the negative consequences are easily pointed out: mandatory functional separation has negative impacts on investment, innovation and in infrastructure-based competition, which ultimately is detrimental to consumers' welfare, the final goal of regulation.

Concerning *impact on the incentives to invest*, PT welcomes BEREC's position (cf. p. 14) that *while functional separation is recognized to be beneficial in the promotion of intra-platform competition,* ***its effects on infrastructure based competition may be detrimental, as functional separation may lead to a form of monopoly in the access segment of the tele-***

communications market" (emphasis added). PT has always taken the view that functional separation does not promote investment; instead, it hampers investment decisions and ultimately affects infrastructure-based competition. There is a clear inconsistency between functional separation and the policy of promoting infrastructure-based competition.

It is very important that BEREC recognizes this aspect, since the objective of promoting infrastructure-based competition has been at the core of the Revised Regulatory Package and is the principle underlying modern regulatory policy. We recall that Recital 5 of Directive 2009/140/EC states that the objective of the new package is "*to progressively reduce ex-ante sector specific rules as competition in the markets develops and, ultimately, for electronic communications to be governed by competition law only*". Also, the new Article 8/5 (c) and (d) of the Framework Directive sets forth that NRAs must "*safeguard competition to the benefit of consumers and promoting, where appropriate, infrastructure-based competition*" as well as "*promote efficient investment and innovation in new and enhanced infrastructures*".

In this context, PT believes that mandatory functional separation will deter the objective of deploying high-speed broadband networks across the European Union. This is particularly important within the current transition to NGA, which requires an investment-oriented regulatory policy. As BEREC's notices, "*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*". PT agrees with this statement and thus believes that BEREC should clearly indicate in the future guidelines that where investment in NGA (or in other networks) is taking place, NRAs should forbear from imposing functional separation. Otherwise, the adoption of any form of functional separation will jeopardise the investment on high-speed networks and will create barriers to the development of the Digital Agenda.

Concerning *impact on competition*, PT notes that there is no guidance on this matter, which is somehow contrary to BEREC's statement that "*this criterion is the most important to the current activities carried out by NRAs*". We believe that this part of the future guidelines should be more detailed.

Nonetheless, considering that functional separation hinders investment and infrastructure competition, it is clear that competition will be harmed and is highly unlikely that functional separation generates an increase on consumers' welfare. As it is generally accepted, economics literature provides strong support, from both a theoretical and an empirical perspective, that mandatory vertical separation is likely to reduce efficiency and harm consumer welfare.

Moreover, PT is concerned with BEREC's opinion that the *impact on competition* is the criterion that is the most important. PT considers that the impact assessment has to consider all aspects established in Article 13a/2 (c) of the Access Directive. Prioritising a given objective over others seems inappropriate and does not respect the set of objectives laid down in Article 8 of the Framework Directive. We recall that the objective to promote infrastructure competition and efficient investments gained a renewed importance in the context of the Revised Regulatory Package and thus NRAs must permanently consider these aspects when carrying out their tasks.

Finally, we note that there is little guidance for Article 13a/2 (d) of the Access Directive. This provision determines that NRAs must present evidences showing that functional separation is the most efficient means to enforce remedies aimed at addressing the competition problems or market failures identified.

PT believes that the implementation of this rule requires a detailed cost-benefit analysis. The comparison should at least consider two possibilities: (i) costs and expected benefits of functional separation and (ii) costs and expected benefits of a better design and/or stricter enforcement of standard remedies. NRAs should not only present facts demonstrating that functional separation is the most efficient measure from a cost-benefit perspective, but must also present evidence that this measure is the most adequate from a practical perspective, *i.e.*, considering the expected time for its conclusion *versus* the time-frame during which the alleged market deficiencies are expected to exist, and also the operational changes needed for its implementation.

2.1.5. Contents of the draft measure

According to Article 13a/3 of the Access Directive, NRAs intending to apply functional separation must submit a draft measure to the Commission. This document has to include a detailed description of the functional separation obligation that the NRA intends to propose. The elements referred to in Article 13a/3 are mandatory, which means that the draft measure may not be approved when one or more elements are not expressly analyzed.

As regards the guidance BEREC sets out on this matter, PT would like to comment the following in particular.

Concerning the *precise nature and level of separation, specifying in particular the legal status of the separate business entity*, PT has some doubts on the correctness of BEREC's position

that the imposition of the separation into a legally separate undertaking sited within the same group is possible (cf. p. 18). In PT's view, this interpretation should not be endorsed and there are some reasons supporting this conclusion.

First, Article 13a of the Access Directive only refers that NRAs may require vertically integrated operators to place some activities in an *independently operating business entity* and not in an *independently structural business entity*. The difference BEREC points out between *entity* and *unit* does not seem enough to grant NRAs the power to impose separation into a legally different undertaking (even without ownership separation). Second, a comparison between the wording of Article 13a and Article 13b will show important differences on this matter. In the former, the European legislator used the concept of *independently operating business entity*; in the latter, the European legislator used the concepts of *separate legal entity under different ownership* and *separate business entity*, which are broader and different than the concept in Article 13a.

In addition, it is not clear how BEREC's position is compatible with the statement in p. 22, where it refers that Article 13b "*has therefore an extended scope with respect to Article 13a, **where structural separation cannot be imposed as an exceptional remedy***" (emphasis added). It would seem that BEREC understands structural separation as necessarily involving divestment and thus ownership dissociation. However, it is not clear that the concept of *structural separation* does not comprise the creation of a legally separate undertaking within the same group. Although we may accept that no ownership detachment exists in this case, we find it hard to support BEREC's position that such measure *may not* be regarded as structural separation.

Therefore, PT suggests the amendment of this part of the draft guidelines, as it seems to deviate from the provisions in the Access Directive.

Regarding the *identification of the assets of the separate business entity and the products of services to be supplied by that entity*, PT recognizes that this is one of the most important issues to be dealt with by NRAs and the draft measure must take into account the costs for the complex identification of the assets of the separate business entity and the products or services to be supplied by it.

Additionally, PT would like to mention that, in some cases, the separation of assets from an entity to another will not depend on the operator itself. In fact, in several countries, part or the entire access network belongs to the public domain and may not be transferred to an-

other entity by decision of a NRA. In other situations, the management and exploitation of the access network may have been subject to a concession contract. In this case, we found hard to determine how part or the entire access network may be transmitted to a different entity without the amendment of the concession contract. In fact, it is not easy to determine how a decision by NRAs could impact on an infrastructure and on ancillary services whose legal qualification may prevent its detachment from an undertaking to another.

As per *the governance arrangements to ensure the independence of the staff employed by the separate business entity*, PT would like to stress that the transmission of employees from an entity to another must abide by strict rules laid down in labour law. This could hinder the execution of the measures defined by NRAs and we believe that these practical aspects should be taken into consideration when defining the content of functional separation.

With regard to the *rules for ensuring compliance with the obligations*, the best option would be if a NRA itself monitors the application of functional separation. The other options presented by BEREC are too burdensome and expensive for the incumbent and were taken (in cases of UK and Italy) within a specific context of voluntary separation and as such may not be appropriate in a different context.

Finally, concerning the *monitoring programme to ensure compliance, including the publication of an annual report*, the last part of BEREC's guidance, regarding the provisioning of other reports in addition to the annual one, place an unjustified burden on the incumbent and is not mentioned in any part of the Access Directive. In fact, Article 13a/3 (f), only determines the publication of an annual report. Hence, PT urges BEREC to change this part of the draft guidelines so as to reflect the rules in the Directives and not impose more obligations on incumbents than the ones set forth in the legal texts.

2.2. COMMENTS ON VOLUNTARY SEPARATION BY A VERTICALLY INTEGRATED UNDERTAKING

BEREC also provides NRAs with guidance for applying the new Article 13b of the Access Directive. However, PT is concerned that some positions expressed by BEREC may not be entirely in line with the provisions of such Directive.

First, PT stresses that any form of vertical separation, including functional separation, shall remain a strategic, private and exclusive decision of the undertaking involved. The European legislator was not insensible to this matter and thus decided to devise a new proce-

dure applicable to voluntary separation. In PT's view, these rules should be enough to ensure that regulatory objectives are duly pursued.

As to the role of NRAs in cases of voluntary separation, though NRAs must be provided with information on the proposed separation in advance and in a timely manner, it is clear from Article 13b that national regulators were not granted with powers to modify the notified transaction. NRAs' role is strictly to assess the effect of the intended transaction on existing regulatory obligations and on the basis of its appraisal, impose, maintain, amend or withdraw such obligations.

BEREC should recognize that according to the provisions in the Access Directive, voluntary separation is the sole and strategic decision of the undertaking involved and NRAs may not seize this opportunity to impose the terms of separation when in normal conditions it would have to comply with the rules and procedures set forth in Article 13a. In other words, the process of voluntary separation may not be used to mandate the terms of separation bypassing the requirements lay down in Article 13a.

Although BEREC recognizes this aspect (cf. last paragraph of p. 23), we were concerned by its position that "*the rule* [Article 13b] *doesn't specify whether NRAs may affect the project notified by the SMP operator or not*" (cf. first paragraph of p. 23). In PT's view, it is clear that the purpose of the European legislator was not to grant such type of powers to NRAs. Only when national law entitles NRAs for such duties (and if and when this is possible), may these entities enforce amendments to the notified transaction.

As regards the timing of the communication and procedure, PT takes due note of the efforts BEREC made to define a possible process for assessing voluntary separation. However, PT was somehow concerned by the fact that BEREC defined a preliminary assessment of the notification. In our view, this initial level of analysis seems to deviate from the wording and requirements of the Access Directive and may be used by NRAs for imposing the terms of the separation.

We understand that an operator may choose to consult a NRA on the proposed separation and only decide to present the planned transaction after some sort of clearance from that authority. However, we believe that BEREC should not consider that NRAs have powers that were not expressly granted in the Revised Regulatory Package.

Moreover, bearing in mind that voluntary separation is a strategic and exclusive decision of an undertaking, how should one understand BEREC's position that NRAs may reject a proposed transaction when it is *manifestly unreasonable* (cf. p. 24)? What are the grounds that support such type of decision? PT stresses that the provisions in the Access Directive do not invest NRAs on such type of powers and thus we call on BEREC to revise this part of its document so as to ensure that the future guidelines fully comply with the rules on the Directives.

Finally, although the notifying undertaking may decide to wait for the NRAs to finalize its coordinated analysis before implementing the proposed transaction, it is clear from the provisions in the Access Directive that the implementation of voluntary separation is not dependent on a favourable decision from a NRA. The only obligation is to previously inform NRAs of the separation intention and to keep this authority updated on any subsequent changes. In this context, BEREC's position that NRAs could decide to condition the modification of the existing remedies to the implementation of the transaction (cf. p. 25) may not be applicable and we are concerned that this may be seem as a form of limiting voluntary separation.

Instead of defining a "possible process" that may turn out to be inflexible and not adjustable to the dynamics of the market, PT considers that BEREC's guidance on voluntary separation should be in accordance with the text of the Access Directive.