

## ETNO Reflection Document commenting on the draft BEREC Guidance on functional separation



November 2010

### Executive Summary

- ETNO commends the Body of European Regulators for Electronic Communications (BEREC) for its initiative in providing guidance to its members on the potential imposition of functional separation as a regulatory remedy under the revised regulatory framework for electronic communications (the “Framework”)<sup>1</sup>. Given that functional separation is a non-standard, exceptional measure, its justification and proportionality must be well-established by a national regulatory authority (NRA) according to objective criteria;
- ETNO reminds BEREC of its position during the 2007-2009 ‘Telecoms Review’,<sup>2</sup> where we argued that mandatory vertical separation, including functional separation, is inappropriate in the Framework where promoting efficient investment and infrastructure-based competition are objectives;
- The Economics literature provides strong support, from both a theoretical and an empirical perspective, for the proposition that mandatory vertical separation is likely to reduce efficiency and reduce consumer welfare;
- One can also raise empirical challenges to the appropriateness of mandatory functional and other forms of vertical separation;
- BEREC itself expresses concerns about the potential negative impact of mandatory functional separation on investment, innovation and infrastructure-based competition;

<sup>1</sup> The directives and regulation adopted in November 2009 to amend the ‘New Regulatory Framework’ (NRF), the set of five directive adopted in 2002, including the ‘Framework Directive,’ the ‘Authorisation Directive,’ the ‘Access Directive,’ the ‘Universal Service Directive’ and the ‘e-Privacy Directive.’. The directives are to be transposed into national law before 25 May 2011.

<sup>2</sup> The legislative process for revising and amending the NRF.

- BEREC even appears to recognise the inconsistency of imposing functional separation under the Framework which is to promote infrastructure-based competition, stating:  
 “While functional separation is recognised to be beneficial in the promotion of intra-platform competition, effects on infrastructure-based competition may be detrimental, as functional separation may lead to a form of monopoly in the access segment of the telecommunications market”;
- In this context, ETNO calls upon NRAs to exercise regulatory forbearance in imposing functional separation;
- For cases where forbearance is deemed inappropriate, ETNO welcomes BEREC’s effort to identify the essential elements and criteria to be included in the analyses of a NRA when ‘making the case’ to impose functional separation. We call upon BEREC, however, to revise its draft guidance to add depth and rigour to the justification and proportionality conditions;
- ETNO maintains that voluntary functional separation, like that introduced in Italy, or any other form of voluntary vertical separation should remain the decision of an individual company;
- ETNO welcomes the opportunity to participate in a public consultation on a draft BEREC report, having long argued that all reports and other communications with potential material impact on industry stakeholders, such as this one, should be consulted upon.

## GENERAL REMARKS

As ETNO argued<sup>3</sup> during the 2007-2009 ‘Telecoms Review,’ the proposed introduction of functional separation into the Framework was not based on any cost-benefit analysis or regulatory impact assessment. Instead, it was politically motivated, linked to NRAs reliance on mandatory unbundling and the concept of the ‘ladder of investment’ in their implementation of the Framework.

Existing access remedies under the Framework can be imposed to ensure non-discrimination by imposing rules on an operator deemed to have significant market power (SMP). In the context of the Telecoms Review, NRAs – supported by the European Commissioner for Information Society and Media at the time -- claimed that these

<sup>3</sup> See ETNO RD265, “ETNO Reflection Document on a functional separation remedy in telecoms,” June 2007.

remedies “might not be enough”<sup>4</sup> to prevent discriminatory behaviour from a vertically integrated operator. “ERG (the European Regulators Group) believes functional separation can be a supplementary remedy in markets where non-discrimination has been shown to be ineffective in dealing with problems of equivalence in wholesale markets.” they concluded on foot of a high-level, non-quantitative analysis.

Now, as then, ETNO also argues that insufficient attention has been given to the theoretical and empirical case against functional separation.

## Case against functional separation in the Economics literature

The Economics literature provides strong support, from both a theoretical and an empirical perspective, for the proposition that mandatory vertical separation is likely to reduce efficiency and harm consumer welfare<sup>5</sup>.

The theoretical case against vertical separation is very strong in particular in predicting that mandated separation will discourage innovation and investment in new technologies. BEREC recognises this itself in this paper [p.16], stating “It is broadly acknowledged in the economic literature that functional separation will reduce these incentives on both incumbent and alternative operators.”

## Empirical reviews challenging functional separation

ETNO would like to highlight a few empirical cases where the appropriateness of functional separation has been challenged:

- In 2008, the Portuguese NRA, ANACOM, engaged Oxera and Ellare Consulting to undertake a comprehensive analysis to assess the extent to which this obligation could be an appropriate remedy to address the subject of functional separation within the context of the Portuguese local access and wholesale broadband markets. The July 2009 report<sup>6</sup> did not draw firm conclusions on the appropriateness of functional separation when considering the following:
  - size of change, which is a function of the cost, timescales and complexity of the separation options relative to each other;
  - market outcomes -- namely, their effectiveness in addressing actual and potential discrimination concerns in the provision of wholesale products which

<sup>4</sup> See ERG (07)44, “ERG Opinion on Functional Separation,” October 2007.

<sup>5</sup> For example, see Crandall, R., J. Eisenach, and R. Litan “Vertical Separation of Telecommunications Networks: Evidence from Five Countries,” Federal Communications Law Journal, June 2010; LaFontaine, F. and M. Slade, “Vertical Integration and Firm Boundaries: The Evidence,” Journal of Economic Literature 45:3, 2007.

<sup>6</sup> Oxera and Ellare, “Vertical functional separation in the electronic communications sector - What are its implications for the Portuguese market?” prepared for ICP-ANACOM, July 2009.

- could lead to a potential to increase in competition in the market, as well as the risk of quality of service disruptions in the short run;
- investment incentives and innovation by both the SMP operator, Portugal Telecom, and alternative operators;
  - regulatory costs and benefits;
- Contrary to the positive assessment of the voluntary functional separation of BT found in draft Annex I, Oxera and Ellare Consulting<sup>7</sup> and others<sup>8</sup> challenge the causal 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):
    - As BEREC itself notes, functional separation was introduced “along with other regulatory changes.” According to Oxera and the Office of the Telecommunications Adjudicator (OTA) publications between September 2004 and December 2005<sup>9</sup>, BT instituted operational improvements in the delivery of LLU before the creation of Openreach in 2006. And in May 2004, a 70% reduction in the price of shared LLU and a 40% reduction in the price of full LLU had been introduced to improve the attractiveness of these ‘rungs of the ladder’;
    - As BEREC itself notes, the quality of the service offered by the ‘equality of input’ (EoI) access products of Openreach is not always very high. Oxera also remarked that the experience with EoI does not prove that high quality levels will be guaranteed; rather, it guarantees equally lower quality;
    - A number of analyses and BT’s own financial reporting<sup>10</sup> have documented the tremendous operational costs and capital expenditure borne by BT in its functional separation and the establishment of Openreach. Much of these costs comprise a pure ‘deadweight loss’;

---

<sup>7</sup> *Ibid.*

<sup>8</sup> For example, IDATE Consulting & Research, “Functional separation in telecoms: panacea or plague? An empirical assessment,” March 2008.

<sup>9</sup> Oxera and Ellare, “Vertical functional separation in the electronic communications sector - What are its implications for the Portuguese market?” prepared for ICP-ANACOM, July 2009, page 101.

<sup>10</sup> BT has stated that it spent over £100 million on functional separation measures. Additionally, BT indicates that its capital costs have increased following the functional separation (see BT Annual Report 2007, page 36-37): for the BT Retail business unit, capital expenditure (CAPEX) increased 8% due to extra expenditure on the implementation of the systems developed required by the Undertakings; for the BT Wholesale business unit, CAPEX on property, plant and equipment and computer software increased by 4% (reflecting both preparations for the 21CN programme and for compliance with the Undertakings); for Openreach, capital expenditure on property, plant and equipment and computer software was £1,108 million, an increase of 7% in the 2007 financial year.

- The Dutch NRA, OPTA, specifically investigated the applicability of the Openreach model for its domestic markets. Based on a study by the consultants NERA<sup>11</sup>, OPTA concluded that the creation of an independently overseen, separated division was unnecessary because the access market included of cable network operators with extensive network reach. In the context of the access competition faced by KPN, imposing functional separation was deemed to be disproportionate.<sup>12</sup> According to OPTA, a imposing functional separation would disadvantage the incumbent, while falling short of guaranteeing equality of access across all national infrastructures;
- After an internal analysis in 2007, the French NRA, ARCEP, determined that functional separation would not act as an “effective and proportionate measure” in view of the costs involved and its uncertain effect on levels of network investment<sup>13</sup>;
- In Sweden, TeliaSonera, made a voluntary separation of its entire passive infrastructure into a separate legal entity as of 1 January 2008. In doing so, it instituted, among others, a board for supervising non-discrimination, the “Equality of Access Board,” which includes external members. It is noteworthy, as reported by BEREC in draft Annex I (p.22), that the Swedish NRA, PTS, has not formally endorsed the separating measures, deeming the voluntary separation “not able to bring any major improvement to the competitive conditions of access markets.” In the context of PTS’ conclusion, it could be argued that if the market situation is at a stage where voluntary separation is not able to deliver benefits then neither would a mandated separation;
- Contrary to BEREC’s presentation in draft Annex I, we would argue that the Polish case is not one of functional separation. On the contrary, the Polish NRA, UKE, has decided to give greater importance to negotiations between operators and to postpone any discussion about functional separation. In conjunction with TP, the SMP operator, and other industry players, UKE has implemented an alternative to functional separation, with the common goal of eliminating concerns about non-discrimination and of protecting the market from potential anti-competitive practices. In parallel to this regulatory process, TP has invested in network infrastructure expansion that is in line with UKE expectations. ETNO thus calls for a revision of “Polish case” section, including removing

<sup>11</sup> NERA Economic Consulting “Ofcom’s Strategic Review of Telecommunications and BT’s Undertakings,” prepared on behalf of OPTA, 15 February 2007.

<sup>12</sup> OPTA, “All-IP: beleidsregels en functionele scheiding,” 2 March 2007.

<sup>13</sup> ARCEP, “La Lettre de l’Autorité – Functional Separation Special Edition,” No.55, March-April 2007: “. . . it is possible that functional separation will result in increased network access costs for all the operators across the board.”

references to a problematic situation and clearly indicating that the case relates to the non-adoption of functional separation because a more efficient alternative was implemented.

## **Inconsistency of functional separation with policy objective of promoting infrastructure-based competition**

Returning to the issue of investment, ETNO maintains that the transition to next generation access networks (NGA) requires an investment-oriented regulatory framework. We believe that mandatory functional separation is not suited for achieving the policy goal of the deployment of ubiquitous high-speed broadband infrastructures across Europe. The imposition of functional separation will reduce incentives to invest and to innovate. Thus it is not only inconsistent with the Framework's policy objectives of promoting infrastructure-based competition but also with the objectives for "fast and ultra fast broadband" of "Digital Agenda for Europe"<sup>14</sup> and the "Europe 2020" strategy<sup>15</sup> of the European Union.

The industry trend towards next-generation networks (access and core) and fixed-mobile convergence relies on a simplification and unification of systems and networks. Functional separation would be a development in the opposite direction.

Possibly without realising it, BEREC points out the inconsistency - or even tautology - in imposing functional separation under the Framework which has as a key objective "safeguarding competition to the benefit of consumers and promoting, where appropriate, infrastructure-based competition"<sup>16</sup>:

"While functional separation is recognised to be beneficial in the promotion of intra-platform competition, effects on infrastructure-based competition may be detrimental, as functional separation may lead to a form of monopoly in the access segment of the telecommunications market" [p.14].

As per the revised Access Directive, and as endorsed by the BEREC draft, functional separation is a measure of 'last resort' to be taken when all other regulatory measures have proven ineffective. In this regard, Article 13(2) of the directive establishes as a pre-requisite for concluding whether functional separation is warranted that there be "no or little prospect of effective and sustainable infrastructure based competition within a reasonable time-frame." [see below for further treatment of this issue].

---

<sup>14</sup> European Commission, "A Digital Agenda for Europe," COM(2010)245, 19 May 2010.

<sup>15</sup> European Commission, "Europe 2020 – A strategy for smart, sustainable and inclusive growth," COM(2010)2020, 3 March 2010.

<sup>16</sup> Framework Directive, Article 8(5)(c).

## COMMENTS ON SPECIFIC ELEMENTS OF GUIDANCE

Below we comment and raise concerns about section 2, “Guidance on functional separation in the revised Framework (Articles 13a and 13b of Access Directive).”

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

#### Functional separation as a non-standard / “exceptional” measure

ETNO welcomes BEREC’s emphasis on the exceptional nature of the remedy under the Framework with reference to Recital 61 of the Better Regulation Directive.

We endorse BEREC’s view that mandatory functional separation as a very intrusive, exceptional, non-standard and difficult-to-reverse remedy.

Given this exceptional nature -- in particular, the difficulty of reversing separation once imposed, we believe that particular attention needs to be given to the analysis of proportionality. The ‘Fedesa case’ of the European Court of Justice (Case C-331/88 of 13 November 1990) , which provides guidance on the application of proportionality, should not be referred to only in a footnote, as in the draft report, but be given primacy. As per the Fedesa case, an NRA proposing functional separation would have to conduct an assessment that:

- i) the measures are appropriate and necessary in order to achieve the objectives legitimately pursued;
- ii) when there is a choice between several appropriate measures recourse is made to the least onerous; and
- iii) the disadvantages caused are not disproportionate to the aims pursued.

#### Procedures

##### *Market analysis procedure*

ETNO, similar to the BEREC, believes in the primacy of the market analysis process enshrined in the Framework. In all circumstances, the imposition of a certain remedy can only be based on a thorough market analysis, a finding of SMP on the relevant market and a decision on remedies that is justified by the competition problems identified taking into account the specific circumstances in the country in question.

In this context, we object to BEREC statements such as the one found on p.11 of the draft: “This means that if for instance the exceptional remedy is designed to include both wholesale bitstream and local



access, the NRA can come to that conclusion after analysing both those relevant markets.” It would suggest that a NRA has a pre-conceived intention to impose functional separation even before conducting a market analysis.

It is also appreciated that BEREC emphasises that when an incumbent’s network is not an ‘essential facility,’ discriminatory practices cannot be assumed to have a negative impact on the competitive conditions such as to justify imposing functional separation. Moreover and in the first instance, the fact that the network under consideration does not constitute a ‘bottleneck,’ or essential facility, must similarly affect also any of the other obligations under Articles 9 to 13.

To take into account existing and potential competition with the market under consideration, BEREC should strengthen the corresponding guidance with regards to market analyses that need to be stronger geared to the different geographical market conditions and competitive landscape within sub-national markets.

#### ***Proposal to Commission***

See comments in relevant section below.

#### ***Submission of draft measure***

See comments in relevant section below.

#### ***BEREC opinion***

The Framework and the BEREC Regulation recognise that BEREC has an important role when it comes to developing a consistent regulatory practice. If BEREC is to execute this role and issue an informed opinion on proposed functional separation in a timely manner, it should be appropriately informed, receiving the same information contained in the proposal and draft measure submitted to the Commission.

#### ***Advisory procedure by Communications Committee***

If the Communications Committee (COCOM) is to issue an informed advisory opinion on proposed functional separation in a timely manner, it should be appropriately informed, receiving the same information contained in the proposal and draft measure submitted to the Commission.

Coordinated market analysis stage and imposition of remedies

Without prejudice to the view that NRAs should refrain from imposing functional separation, we urge BEREC to strengthen its position that “it is reasonable that NRAs would not maintain current



remedies when separation have been implemented and adequately address the market failures” [p.12].

According to Article 13a and 13b, in case of an undertaking on which functional separation has been imposed, a NRA shall impose, maintain, amend or withdraw obligations. Where functional separation is mandated, existing other remedies will likely no longer be justified and proportionate. There is thus a compelling case to withdraw other obligations when functional separation is imposed. And such deregulation would be applicable not only for the corresponding access market but also for adjacent markets.

BEREC mentions that the analysis of relevant markets should be conducted after a reasonable time “for the imposed measure of functional separation to have an effect” (p. 12). ETNO urges BEREC to provide guidance on this timeframe to avoid further market distortions resulting from the continued application of standard remedies in parallel with functional separation.

### **Contents of the proposal to the Commission**

ETNO welcomes BEREC’s effort to identify the main criteria that should guide the analysis of a NRA prior to the submission to the Commission of a draft proposal for the imposition of functional separation. We do not believe, however, that it defines criteria and supporting analyses with sufficient rigour.

### ***Evidence justifying the conclusions of the NRA***

Generally, BEREC suggests that a low take-up of LLU by a class of alternative operators is equivalent to a lack of effective competition and is a compelling reason to consider functional separation. A lack of effective competition from operators availing of wholesale bitstream access and LLU, however, should not be seen to be caused or necessarily linked to discriminatory behaviour on the part of a SMP operator. Ineffective competition can be the result of numerous factors, ranging from poor corporate management to lack of investment to the presence of infrastructure competition from alternative platforms. Accordingly, ETNO requests that BEREC revise its guidance in this respect.

As BEREC rightly states, a NRA has to provide evidence justifying its conclusions that the conditions of Article 13a(1) are met, i.e., “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 [...]”

The evidence brought to bear should include an assessment of whether:

- competition problems and/or market failures actually existed and were not only theoretical or alleged;
- the imposition of appropriate obligations (from the standard set of remedies) has been effectively enforced by the NRA and actually availed of by service providers and alternative operators;
- the enforcement of obligations has been ineffective in addressing the competition problems and/or market failures;
- any remaining competition problems and/or market failures are important and persistent.

BEREC correctly emphasises that 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.

The NRA should also evaluate whether a more comprehensive design and stricter enforcement of the measures in Articles 9 to 13 would be sufficient. In this respect, the draft report (pp.9-10) states that a NRA will need to assess whether the standard wholesale access obligations not only have been properly imposed but also “systematically enforced.” The draft report then provides examples of activities which could represent “a substantial track record of the enforcement activity against the SMP operator regarding instances of discrimination.” ETNO objects to the draft report’s suggestion that the mere existence of enforcement activity implies anti-competitive behaviour and is thus sufficient to justify functional separation.

In the presence of a positive evidence base, a cost-benefit analysis should then follow, comparing at least two possibilities:

- expected costs and benefits of a functional separation obligation;
- expected costs and benefits of a better design and / or improved enforcement of the standard remedies of Articles 9 to 13 of the Access Directive.

This comparison would be necessary in order to comply with the requirements of art. 13a.2d of the Directive: “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” [emphasis added].

For conducting this cost-benefit analysis, BEREC should define guidance in line with the advice of the Organization for Economic Cooperation and Development (OECD):

“Not only should benefits be demonstrably in excess of costs, there should also be sufficient evidence that separation is the most cost-effective approach to achieving the desired effects

and that a less disruptive behavioural remedy that achieves the same goal at lower cost is not available.”<sup>17</sup>

***Reasoned assessment that there is no or little prospect of effective and sustainable infrastructure-based competition within a reasonable time-frame***

Article 13 (2) of the Directive establishes as a pre-requisite for concluding that functional separation is warranted that there is “no or little prospect of effective and sustainable infrastructure based competition within a reasonable time-frame.” ETNO maintains that the draft report fails to adequately address this pre-requisite. Instead, BEREC erroneously equates this to mean “to assess the likelihood of investments in new access infrastructures by alternative operators.” This is a fundamentally different reading which deviates from the wording of the Directive.

ETNO believes that a NRA needs to assess the existence of effective and sustainable infrastructure-based competition – in the entire market and not only from access seekers which have been availing of wholesale bitstream access or LLU to date. This would necessarily involve an assessment of the prospect of competition taking into account competing access platforms, including, for example, cable, wireless, mobile and satellite. If the NRA finds that industry players investing in these alternative platforms offer the prospect of sustainable and effective competition with the incumbent, it cannot come to the conclusion that functional separation is necessary.

Moreover, functional separation of the copper network risks slowing platform competition. For example, in the UK in the years prior to the adoption of the functional separation model, the penetration of cable broadband grew by over 100% annually but dropped to 23% afterward.<sup>18</sup>

ETNO respectfully requests BEREC to give explicit guidance on this condition in a manner conforming to the Directive and to amend it draft report accordingly.

***Analysis of the expected impact***

To assess the impact of imposing functional separation, a NRA should conduct a comprehensive and quantitative cost-benefit analysis of the following, as per Article 13a(2)(c) on:

- the regulatory authority;
- the undertaking, in particular on the workforce of the separated undertaking;
- the electronic communications sector as a whole;

---

<sup>17</sup> *Ibid.*

<sup>18</sup> Len Waverman, “The New-New EU Regulatory Framework: Barking up the Wrong Tree?”, presentation at the ETNO Annual Conference, 22 November 2007, Brussels.

- the incentives to invest in a sector as a whole, particularly with regard to the need to ensure social and territorial cohesion;
- On other stakeholders including, in particular, the expected impact on competition and any potential entailing effects on consumers.

With regard to the potential significant costs and manifold risks of mandated functional separation, a thorough quantitative assessment is one of the most difficult issues to be addressed by the NRA. While a very challenging and resource-intensive task, ETNO maintains that it is indispensable.

ETNO was thus quite concerned to read in this draft report BEREC's opinion that the "impact on competition" is the criterion that is "the most relevant to the current activities carried on by NRAs." ETNO maintains that a NRA should ensure compliance with all of the objectives set out in Article 8 of the Framework Directive, which informs Article 13a(2)(c) , while striking a balance between them. Prioritising a given objective over others would be inappropriate. Moreover, no reason can be found why in a cost-benefit analysis certain factors should be given more weight than others.

#### On the regulatory authority

In the draft report, BEREC assumes that the costs of functional separation will mainly increase in the short term for the NRA and likely will be lower in the long run. It is, however, very likely that the level of regulation needed will remain very high, as concluded by the French NRA, ARCEP, when reviewing the UK example.<sup>19</sup> In the UK, the level of regulation did not decrease with functional separation, as it added an additional layer of regulation by re-creating monopoly control of the copper access network.

On the undertaking, in particular on the workforce of the separated undertaking

ETNO calls upon BEREC heed the concerns raised by ARCEP<sup>20</sup> in this domain:

"... generally speaking, the implementation of functional separation entails costs which are well in excess of those involved, for instance, in the implementation of accounting separation. These costs relate to the reorganisation of the company, the duplication of technical staff and engineers and, in general, the splitting up of various activities which had presented a certain degree of synergy."

Such an analysis should take into account costs for information technology systems, loss of economies of scale and scope, reduced

<sup>19</sup> ARCEP, "La Lettre de l'Autorité," No 55, March-April 2007: "Functional separation does not remove the need for regulation of prices, quality of service, investments or the services offered in the access network."

<sup>20</sup> *Ibid.*

incentives to invest of the regulated undertaking, the costs for arrangements that ensure the independence of the staff employed by the separate business entity and the corresponding incentive structure. It also should include costs for the complex identification of the assets of the separate business entity and the products or services to be supplied by that entity, as well as the long term costs of a wrongly defined demarcation, The costs of compliance with the measure and of a corresponding monitoring programme and costs for implementing rules for ensuring transparency of operational procedures should also be fully taken into account.

On incentives to invest in a sector as a whole, particularly with regard to the need to ensure social and territorial cohesion

We share BEREC's observation that there will be less incentives for competing operators to gain independence from the incumbent through the deployment of own infrastructure (p.16). However, we find no economic arguments or empirical evidence to support the view that "Nevertheless, 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)." Functional separation and EoI access could lead alternative operators to invest in LLU, but it is difficult to infer that this investment would lead them to deploy their infrastructure further, and then incentivise the incumbent to invest in fibre. There is limited experience to date of access seekers availing of LLU doing so.

Additionally, BEREC does not take into account the fact that due to functional separation investments might be delayed. This delay is, however, very plausible as highlighted by Martin Cave.<sup>21</sup>

When considering the impact of functional separation on investment, BEREC refers to the universal service obligations as an alternative means of ensuring the desired network development (p. 16). After removing economic incentives for investment by introducing functional separation, it would be highly inappropriate to oblige the affected enterprise to carry out such investments within the scope of universal service obligation.

On other stakeholders including, in particular, the expected impact on competition and any potential entailing effects on consumers

BEREC states that "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." BEREC then continues, "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" (p. 17). ETNO questions how

---

<sup>21</sup> Martin Cave, "Structural design for effective competition", presentation for the 11th ACCC Regulatory Conference 29-30 June 2010.

BEREC can conclude that alleged “in principle” benefits will outweigh the admitted negative impact of functional separation on investment. A quantitative cost-benefit analysis is required to demonstrate the real and significant benefits of functional separation for consumer welfare as compared to the impact on investments which – among others – certainly has negative consequences on consumer welfare. For example, innovation at retail level would be limited. As the draft reports cites earlier, the incentives to gain independence from the incumbent is limited, so the improved retail offers are going to turn mainly around price, and not so much about new features, capacities, etc. (Loss of) incentives for innovation should explicitly be considered in the quantitative analysis.

To conclude, we note that traditional tools, i.e. those used for market analyses, are not sufficient for the purpose of a thorough, quantitative assessment; a more comprehensive and dynamic approach needs to be developed and carefully applied. In addition, we agree with BEREC that further sensitivity analyses have to be part of the assessment in order to evaluate the robustness of the results. Even though not explicitly mentioned as a criterion under Article 13a, a sensitivity analysis is to be seen as essential for conducting the impact analysis.

### **Voluntary separation by a vertically integrated undertaking (Article 13b)**

ETNO maintains that voluntary functional separation, like that introduced in Italy, or any other form of voluntary vertical separation should remain the decision of an individual company.

As regards voluntary separation as provided by Article 13b of the revised Directive, ETNO does not have any specific comments on the draft guidance provided by BEREC.