Fastweb response on Consultation "Draft BEREC Guidance on Functional Separation"

Introduction

Fastweb S.p.A. ("Fastweb"), the second largest broadband operator in Italy, welcomes this opportunity to provide its comments to Berec's draft Guidance on Functional Separation (the "Draft").

1. Definition and scope of Functional Separation in art 13a of the Access Directive

1.1. Functional Separation in art 13a as an exceptional measure implying specific requirements

As a preliminary point, we'd like to highlight that the Better regulation Directive has introduced Functional Separation (FS) as an exceptional remedy to be adopted by NRAs, following a specific procedure, under exceptional circumstances when standard non discrimination remedies have not proven successful in guaranteeing non discrimination.

As such, **guidance is critical to ensure that NRAs opting for this exceptional remedy implement it effectively**, ensuring a truly level playing field between the commercial arm of the incumbent operators and third party access seekers.

To this extent, and in order to guarantee an harmonised application of the Better Regulation Directive, it is essential to make a clear-cut distinction between FS as intended by Art 13a and other tools to ensure non-discrimination: if we agree in principle that the aim of FS is to guarantee Equality of Access (EoA), it is also true **that not all attempts to achieve EoA can be labelled as FS and therefore fall under the definition and procedure of Art 13a.**

In this context we'd like to highlight how the Draft, by suggesting that the purpose of FS provision in the directive is to ensure "*no matter what form is chosen*" an "*equivalence of access*" and that this can be achieved either through Equivalence of Input (EoI), in which the same wholesale products are provided through the same processes and systems to both the retail arm of the incumbent and alternative operators, or Equivalence of Output (EoO), in which wholesale products provided internally and to third parties are "comparable" and offered through different processes and systems, may be misleading. In fact, **the wording of the Directive as well as the relevant economic literature provide a more specific definition of what should be interpreted as a Functional Separation** and the specific requirements it involves.

In order to qualify as the non standard remedy introduced by the Directive, FS has to comply with several formal and substantial requirements: the wording of Article 13a allows NRAs to "*impose an obligation on vertically integrated undertaking to place activities related to the wholesale provision of relevant access products in an independently operating*

business entity" supplying "*access products and services to all undertakings, including to other business entities within the parent company, on the "same timescales, terms and conditions, including those relating to price and service levels, and by means of the same systems and processes*".
It is therefore clear how the Directive:

(i) requires a **relevant change in the organizational structure** through the set up of a separate business entity, introducing governance rules and other measures that ensures that the separate business unit operates independently from the rest of the vertical integrated company;

(ii) considers **Equivalence of Inputs - i.e. the provision of wholesale access services through the same (not simply equivalent) timescale, system and processes - a mandatory element of FS as a non standard remedy**.

Different and lighter forms of separations which do not guarantee the independence of the business unit and/or do not ensure EoI would therefore not qualify as Functional Separation and should instead be considered an implementation of the standard non discrimination remedy that NRAs can implement without the burdensome procedure required by art 13a.
As recognised by OFCOM, lighter forms of separation implying, for instance, EoO models can be defined as a stricter and more detailed application of standard non-discrimination remedies: "*The equivalence of outcome model […] in some respect is similar to the approach adopted by Oftel. […] The Oftel approach started from the position that the regulated wholesale products that BT offered to its wholesale customers should be comparable to those that BT offered itself, though there was no requirement for the use of exactly the same product and processes. […]However, the Oftel approach has not been successful in delivering equality of access. In each case it took several years before viable regulated wholesale products were made available and in some cases there remain significant areas of lack of equivalence. As well as being unsatisfactory to citizens, consumers and the telecoms industry, this approach has created a need for the regulator to take a far more active role in wholesale product design than is desirable.*

By suggesting that NRAs can implement art 13a through different and "lighter" forms of separation, including those that do not require the SMP operator to guarantee the same timescale and the same systems and process in the provision of wholesale services to internal arm and third party access seekers, the Draft:

(i) may create confusion on the correct and harmonised implementation of art 13a

(ii) end up reducing the capability of NRAs to apply effectively standard non discrimination remedies.

1.2. The economic literature and previous evaluation of ERG itself, indicates that EoI is an essential and non disposable element of a true Functional Separation.
As Martin Cave, extensively quoted in the Draft, has stressed, **EoI is an essential element of Functional Separation.** He specifies in its classification "*The next step up (3) involves physical business separation, which requires reworking of underlying business practices and not just changes at the transaction boundary, as with virtual separation. The aim is to*

segregate particular assets and other inputs within a ***separate unit, which then trades using identical processes with both internal and external customers in way that can be verified transparently***."

The nature of essential requirement of EoI in FS was recognised by ERG itself in its response to European Commission's review of the EU electronic communications regulatory framework of October 2006: "*The concept of 'equivalence of input' needs to be included explicitly in the definition of non - discrimination currently detailed in article 10 of the Access Directive*"[1] and again in its Opinion on Functional Separation delivered in 2007: "*In order to prevent the employees running these bottlenecks assets having the motive and ability to favour the company's own downstream affiliates to the detriment of competitors,* ***a functional separation remedy would require - as a minimum - that the same products and services that are provided to the company's own downstream affiliates are equally provided to alternative providers, using the same ordering and handling processes***."[2]

As pointed out by the OFCOM[3] in assessing the effectiveness of EoO and EoI: "*The disadvantage of the equivalence of outcome model is that it will not necessarily overcome all of the problems of the approach used by Oftel, and* ***therefore might not achieve equality of access****. BT would still have some incentive and ability to access the network more efficiently. Though there is a higher requirement for equality,* ***this model still requires regulatory intervention to decide whether differences between regulated wholesale products are acceptable, and therefore there still remains the potential for lag****. There are also the same problems of lack of transparency, information asymmetry and the incentive to game the regulator* "

In order to provide effective guidance, the Draft should highlight how, besides not being compliant with art 13a, a separation based on EoO would not eliminate SMP incentives to discriminate against Altnets and does not reduce the regulatory and monitoring burden on the NRA. As OFCOM correctly argues[4]:

i. EoI generates better incentives for the incumbent operator to provide high quality wholesale products to its wholesale customers, because if a regulated wholesale product or process is lacking in some way, the incumbent would be incentivised to solve the problem since its retail activities would suffer from the problem as well as its competitors;
ii. EoI increases transparency and reduces information asymmetry, since the process and systems used to deliver essential input are not any more in the hand of one operator, but are monitored and continuously ameliorated by the participation of several operators. One

[1] See ERG, *Response to the Review of the EU Regulatory Framework for electronic communications network and services*, pag. 5. Document available at: http://www.irg.eu/streaming/461.pdf?contentId=543337&field=ATTACHED_FILE
[2] ERG Opinion on Functional Separation, pag. 3.
[3] Consultation Document of the Phase 2 of the Strategic Review of Telecommunication (TSR), http://stakeholders.ofcom.org.uk/binaries/consultations/telecoms_p2/PolicyAnnexes_FL.pdf
[4] Consultation Document of the Phase 2 of the Strategic Review of Telecommunication (TSR), http://stakeholders.ofcom.org.uk/binaries/consultations/telecoms_p2/PolicyAnnexes_FL.pdf

of the key problems of the EoO is precisely that this model does not address the issue of transparency and information asymmetry.

iii. The increased transparency makes easier for NRAs to monitor compliance. Indeed, given the lack of transparency and comparability of products and process inherent in the EoO model, it is difficult either for Altnets or for NRA to check for compliance. In the equivalence of input model these problems are largely overcome;

iv. The beneficial effects listed above it require less intervention by NRA. The requirement for NRA to intervene to determine whether differences were acceptable and effectively to design products would be substantially reduced. On this measure, EoI is not only a superior approach to the historic regulatory approach, but is also superior to an EoO model.

To conclude, FS referred to in Art. 13a, in line with relevant economic literature, is characterized by (i) the creation of an **independently operating business entity** in charge of the provision of wholesale services (ii) the guarantee that wholesale services are provided to all undertakings on the same timescales, terms and conditions, and by means of the same systems and processes. **A form of separation that does not imply a separate and independently operating business entity and which does not ensure that the same products, timescale, prices, processes and system are guaranteed to both internal and external customers, should not fall within the definition of Art 13a** and should instead be interpreted simply as a more detailed and stricter application of the standard non-discrimination remedy, leaving NRAs the freedom to adopt such measures without going through the "exceptional" and burdensome procedural regime envisaged by art 13a. **By including lighter forms of "separation" in the scope of art 13a, the Draft might create confusion on the correct application of the measure as well as reduce NRA's ability to impose standard non discrimination remedies.**

In order to provide a correct guidance to NRAs, **the Draft should**, rather than refer to all forms of implementations as qualifying to achieve FS and all forms of separation as being effective to achieve EoA, **recognise that there is a wide consensus among economic literature and regulators on**

(i) EoI as a mandatory element for a separation to qualify as FS under Art 13a

(ii) EoI being far more effective than EeO in guaranteeing non discrimination.

2. Content of the draft measures

As remarked, Art 13a introduces Functional Separation as a non-standard remedy for the NRA to ensure non-discrimination in specific cases where any other standard remedy has not proved effective. As a "last resort" measure, it is extremely important that NRAs have indications to implement this exceptional measure so to resolve the discrimination issues once and for all. Therefore, we welcome BEREC proposal to detail and provide a specific interpretation of the minimum requirements that draft measure proposed by the NRA should include.

Following our comments on some of the elements required by the Directive and listed in chapter 2.1.5 of the Draft:

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

The Draft argues again that the wording of Art. 13a allows NRAs the option to apply "*a range of degrees of functional separation*" explicitly referring to Martin Cave classification and implying that any form of separation included in Table 1 (pag. 6) of the Draft would fall within the non standard FS remedy introduced by Art. 13a.
As explained before, in order to avoid misunderstandings, the Draft should be more specific in underlying how **not all forms of separations fall under the definition provided in art 13a**, but only those ranging from the "minimum required" Functional Separation (level 3) – provided that it guarantees delivery of access services on same timescale and by same processes and systems - to the "maximum" degrees of ownership separation (level 6).

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

The identification of the perimeter of assets transferred to the separate business entity and of services to be provided is one of the most important steps in the procedure outlined in Art 13a to guarantee effectiveness of FS.
A detailed description of all the physical, "intangible" (staff employed, intellectual property) and financial assets transferred to the independent business entity is **essential for the separation to qualify as a FS rather than a "Virtual separation"** (step 2 of Martin Cave taxonomy).
Such a detailed identification of assets transferred to the separate BU is, in fact, relevant in order to make it effectively "separate" and independent from the rest of the organization and is essential also for monitoring purposes, as it allows to define a separate financial report and separate regulatory accounting schemes ensuring that the same prices are effectively applied to both internal and external customers.

It can be useful to recall that in the Italian case, while SMP services provided by Open Access have been specified, **there hasn't been any transparency on the physical and intangible assets associated with the business unit in charge of delivering wholesale access services**.
Since Open Access has been created before the Undertakings, as an internal reorganization of the incumbent operator, nor the NRA neither the Altnets have been involved in the definition of the perimeter and assets of the business unit. The lack of information on the assets of the OA makes it more difficult and monitoring Equivalence of Access and in assessing the correctness of the separate regulatory accounting schemes.
Given the relevance of a precise and transparent definition of the perimeter of the separate business entity, it might be advisable for NRAs to foresee also the definition of an associated separate and transparent financial report for the separate business unit or a consistent draft of separate regulatory accounting and any other information useful to monitor whether the same products are delivered at the same price to all stakeholders.

As a last remark, in this paragraph the Draft mentions again EoO and EoI as possible implementation approaches for FS. **We'd like to stress, once again**, **that if in principle EoO is a mean to achieve equality of access, the wording of Art 13a indicates that only a FS ensuring the delivery of access services on same timescale, and by same processes and systems – i.e. based on an EoI approach - qualifies as the exceptional non-standard remedy,** whereas other, lighter forms of equality of access, may be introduced by NRA without going through the burdensome procedure required by the Directive.

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

The capability of Functional Separation to guarantee non discrimination relies specifically on the **robustness of the governance system.** The effectiveness of the UK separation model, for instance, strongly depends from a governance system which foresees a **specific organisation** for the separate entity (although part of BT group, the entity doesn't report to other managers in the BT organisation), **personnel employed** (all 30.000 employees working on the access network have been transferred to the BU), **separate management** (the separate BU has its own chief executive, CFO, and senior managers in charge of main functions) **separate headquarters**, **separate commercial brand** (on field activities are performed by the separate entity under the commercial brand Openreach, which appears on business cards, vehicles, staff uniforms) and a **separate financial statement** (Openreach publishes its own Profit and Loss statement which provides full transparency on the performances of the business unit). In other cases, the weakness of governance arrangements prevents the staff from perceiving themselves as belonging to a separate business unit and establishing an effective system of incentives, creating no motivation for the separate entity to act independently from the rest of the vertical integrated company.

The Draft should be very detailed in providing a list of measures that can result in effective governance arrangements, such as

- **separate management**: although not legally separated, the separate unit should have its own General Director, not responding to other managers in the vertical integrated company different from the group CEO, as well as separate managers in charge of HR, commercial operations, finance, and so on so to ensure that strategic decision are taken within the unit and not elsewhere in the vertical integrated company;
- **separate staff**: the staff involved in the access network and the delivery of wholesale product should all be allocated to the new business unit with internal and external evidence;
- a **specific brand** should be used by the staff when performing on field activities connected with the delivery of wholesale services, in order to enhance the perception of a separate identity for the staff;
- **separate headquarters**, to reinforce the identity of the BU and prevent flow of information between the separate business unit and the rest of the company;
- **separate operation and business support systems**.

Although the governance rules mentioned above already create a reasonable guarantee of independence of the staff, other mechanisms to prevent discriminatory behaviour should be included:

(i) Procedural rules preventing the illegitimate flow of information between the separated wholesale business entity and retail arm of the SMP operators, foreseeing effective sanctions[5].

In order to result effective, the draft measures should include a detailed explanation of rules preventing the sharing of confidential information as well as a description of the internal monitoring procedures put in place to detect abusive behaviours by business units and applicable sanctions.

(ii) Management by Objectives (MbO) systems connected specifically to financial results of the separate entity

In order to create an incentive for the staff to operate for the profit of that business unit rather than the vertical integrated company and therefore eliminating incentives to discriminate external customer against the internal arm, the **MbO system should be connected to indicators able to capture properly the performances of the separate business unit**.

It should be noted that when, as in the Italian case, the system of incentives sets targets mostly linked to **qualitative indicators not connected to financial performances**, measuring for instance "*satisfaction of end customers and Operators purchasing wholesale access services*", the system is less robust. Unlike quantitative indicators, qualitative ones may be easily manipulated. As an example, in order to assess Altnets satisfaction as wholesale customers, Telecom Italia's Open Access asked them in a questionnaire to answer whether they had "*intention to continue to buy services from Telecom Italia"* not taking into account the monopolistic nature of the services provided by Open Access and the lack of alternative choice Altnets have in acquiring wholesale access services.

The Draft should highlight how FS provides a solution to non discrimination only if managers have a correct and effective incentive to make profit-maximising decisions for to the business entity for which they are responsible. This implies **incentives for management related to the economic and financial performance of the separated business entity only**. The lack of quantitative indicators, associated with a weak governance system, results into management of the separate business unit maintaining the incentive to maximise the profit of the vertical integrated company as a whole and to discriminate against downstream competitors. The

[5] In the Italian experience, Group 2 of Commitments delegates the design and the implementation of measures to prevent discriminatory practices to an internal "Code of Conduct". The Code lacks effectiveness as the detection of discriminatory information sharing practices is delegated to Telecom Italia's internal procedures and, most importantly, the sanctions to be applied are only those envisaged for disciplinary violations by the "Contratto Collettivo di Lavoro" of Telecom Italia's staff and have proven to be ineffective.

Draft should suggest, based on experience developed in the UK, quantitative indicators to be connected to the incentive schemes.

d) "rules for ensuring compliance with the obligations"

Fastweb agrees with the Draft that a compliance body should be in charge of investigating complaints of Alternative Operator against the separate Business Unit, monitoring and reporting to NRAs key performance indicators and making recommendation on how to improve the effectiveness of the Separation. It should be made clear though, that **the existence of a compliance body is not a sufficient element of the governance arrangement to ensure that the separate unit acts independently.**

Also, as remarked in other occasion by the EU Commission[6], the Draft should recall that no decision adopted by the compliance body should in any case interfere or replace the NRA *ex-officio* powers, which should ultimately be in charge for ensuring the correct implementation of the non-standard remedy. To this aim, it should be clarified that in **no way the powers and competences of the compliance body should prevent the Altnets from requiring the intervention of the NRA** in matters relating the compliance with the measures adopted regarding FS.

In order to enhance transparency, the Draft may suggest NRAs to include the requirement for the compliance bodies to publish a report of each meeting.

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

The Draft specifies that, in order to be compliant with the provision of art 13a, the incumbent operator needs to take into account other operators' needs and views when designing changes to the OSS. To allow effective participation of the Altnets to this process, the draft should suggest NRAs to introduce formal procedures for the definition of OSS, such as the establishment of Technical Boards with decisional power, chaired by the NRA and.

The lack of those formal procedure may result in the SMP operator not taking into account the suggestions and requirements of the external customers. In the Italian experience of separation, Altnets have not been granted a sufficient degree of participation in the design of the delivery processes as Technical Boards only has consultive powers. As a result, very few of the suggestions put forward by Altnets have been taken into consideration.

f) "a monitoring program to ensure compliance, including the publication of an annual report"

In order to deliver effective pro-competitive results, a robust monitoring and enforcement system needs to be established. The KPIs should capture the performances of the delivery and assurance processes so to allow, no matter what the organization of the process is, comparison of the performances achieved for external and internal customers.

KPI adopted in Italy, for instance, only measure performances within the separate business entity, not taking into account that processes are different for internal and external customers

[6] See letter SG-Greffe(2009) D/2188, - letter of comments that the EU Commission addressed to the Italian regulator AGCOM on its draft measure on remedies in Markets 1,4 and 5, eventually adopted with Decision 731/09/CONS

and, whereas TI retail interacts directly with Open Access, Altnets orders are first processed by TI Wholesale which in turn interacts with Open Access. As a result KPIs, not measuring the extra leadtime required for Altnets' orders, do not allow measuring "end-to-end" delivery and assurance processes and comparing performances for internal and external customers, making it impossible to assess whether Equivalence of Access is ensured.

The Draft should recommend that **KPOs and KPIs are designed to capture the performances of the entire "end-to-end" provisioning and assurance processes**, starting from the physical provision of input down to the commercial and technical interface of the SMP operator with its retail arm and its wholesale customers. Also, **the Draft should recommend that KPI and KPO always allow to compare monitoring performances of those processes for of internal and external customers**.
Finally, the publication of an annual report should be interpreted as a "minimum requirement" and BEREC should encourage NRAs to publish quarterly or monthly reports on KPIs.

3. Practical experience with FS in EU

Annex 1 of the draft describes separation models implemented in EU countries to provide practical insight drawn from the experience by other NRAs.
Nevertheless, in order for the exercise to provide useful indications, **the Draft should be more specific in describing to what extent those experiences comply with the definition provided by art 13a i.e.:**

(i) can be qualified as FS and
(ii) provide services on same timescale and by same processes and systems.

In this respect it should be made clear that **Openreach in the UK is the only true experience of FS in the EU**, in line with the wording of the directive and with the taxonomy provided by the relevant economic literature.
As stressed above, if the aim of FS is to guarantee Equality of Access, **not all attempts to achieve Equality of Access can be labelled as FS and therefore considered in line with, or providing meaningful experience for the non-standard remedy introduced by art 13a.**

The Draft should clarify that:

a) **Italian model cannot be placed between level 3 and 4 of Martin Cave's classification:**
As already stressed, in order to qualify a separation as Functional, Martin Cave's classification requires, among other elements, identical processes for both internal and external customers: "*The next step up (3) involves physical business separation, which requires reworking of underlying business practices and not just changes at the transaction boundary, as with virtual separation. The aim is* ***to segregate particular assets and other inputs within a separate unit, which then trades using identical processes with both internal and external customers in way that can be verified transparently***"[7].

[7] http://www.med.govt.nz/upload/45612/cave-six-degrees-of-separation.pdf

As it will be extensively explained in the paragraph, nearly none of the elements required by Martin Cave to identify a FS and listed in the table in page 7 (new office locations, separate commercial brand, separate management infosystem...) can be found in the Italian case.
The Draft should therefore **conclude that the separation model implemented in Italy would be more correctly placed between step 1 and 2 of Martin Cave's classification**, rather than between 3 and 4, as originally suggested.

b) **Italian separation model lacks most of the requirements listed by art 13a to qualify as FS**:

- **no indication of the perimeter of the asset has ever been provided** in the voluntary undertakings and assessed by the NRA. As recalled, Open Access (OA) is the result of an internal reorganization, falling outside the scope of the undertakings, in which the NRA was not involved. As a result there is no transparent and public information on the assets transferred to the business unit;

- **no effective governance arrangements ensuring independence**: unlike what happened in the UK with Openreach, Open Access governance arrangements do not guarantee its capability to act independently as:

  - Open Access is not separated and placed outside the organization (like Openreach) but functionally reports to the BU Technology and Operations, which is in charge of other network elements and assets that are functional to TI activities. It is evident how the Manager of Technology and Operation has interest in maximising the results of the vertical integrated company rather than the Open Access BU, therefore giving directions consistently with this interest.
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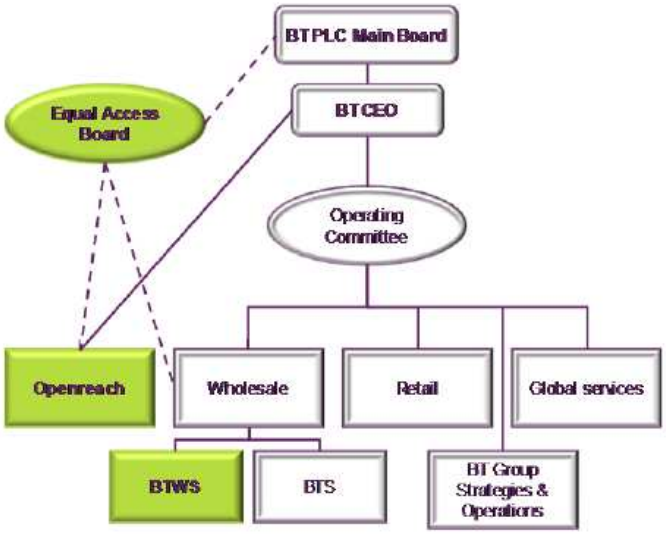
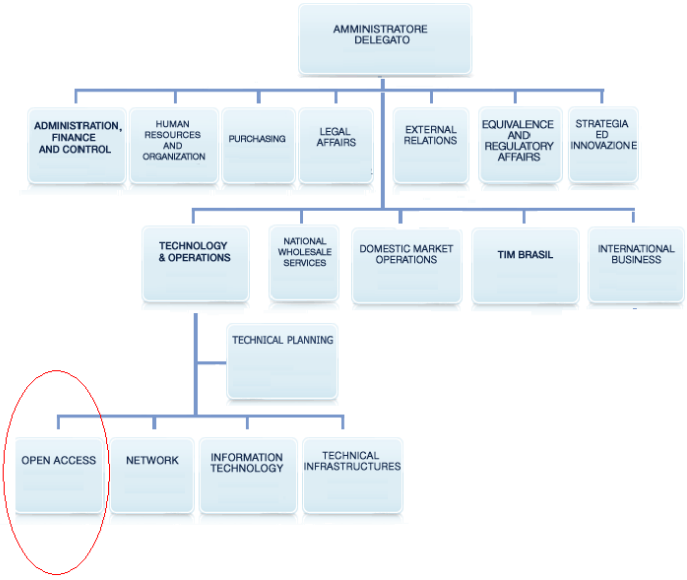
Openreach within BT organizational structure

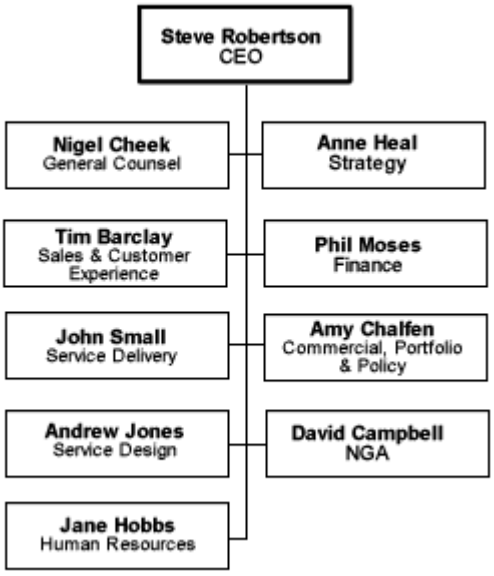


OPEN ACCESS within TI organizational structure

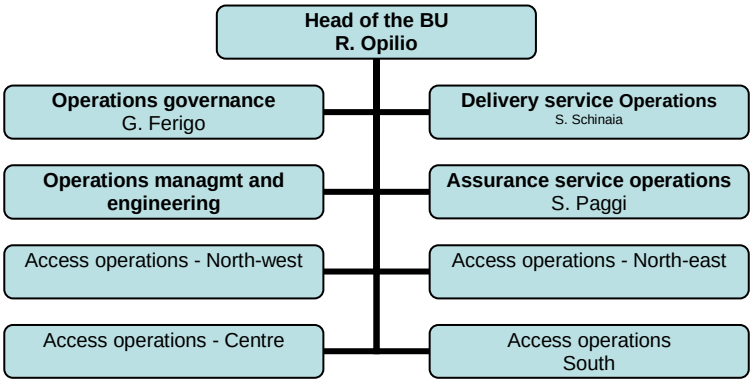


- Open Access has no separate management: whereas Openreach has its own HR, Strategy Head, CFO, commercial director, enhancing the identity of the organization and making sure that **its strategies and objective are decided within Openreach and independently from the rest of the organization**, those tasks for **Open Access are performed by the same managers in charge for the vertical integrated company**. It is clear how Open Access is a purely technical BU, not separate from the rest of the organization and in charge of practical implementing decisions taken in Telecom Italia.

Openreach internal organization

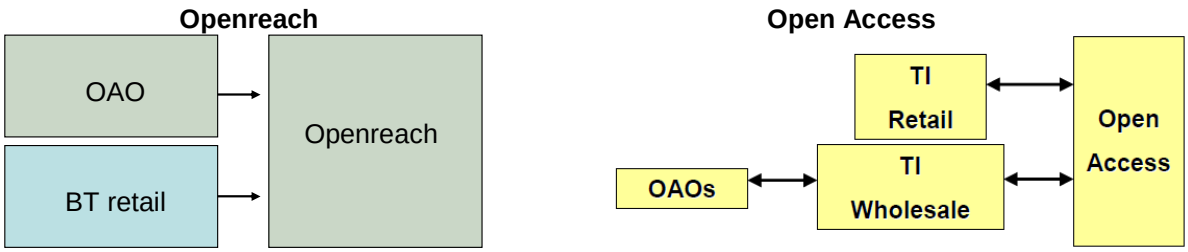


Open Access internal organization



- Open Access has no separate financial report: whereas Openreach has its own finacial profits and losses statement making the performances of the separate unit completely transparent and independent from the rest of the company, economic performances of Open Access are not transparent as the **revenues of the sales of wholesale services are not separate form other revenues of Telecom Italia.**

- **Access wholesale services are not provided internally and externally through the same systems and processes**.
  As extensively explained, whereas Openreach provides internal and external customers through the **same processes and systems**, Open Access maintains separate systems and processes.



- **Access wholesale services are not provided on the same timescale**: whereas TI retail directly interacts with Open Access, Altnets retail divisions have to interact with TI wholesale first which, in turn, interacts with OA. It's obvious how the **process lead-time is *per se* different and longer for Altnets**, whose orders have to be processed by TI Wholesale first, before being sent to OpenAcess for the activation of the delivery process.

- There is **no evidence of the wholesale products being provided internally and externally at the same price**. Unlike the UK where Openreach has its own provisioning/billing system tracking all the transactions (internal and external) and allowing a transparent identification of the quantity of products sold and the prices at which they are sold, **OA doesn't have a billing system. Only TI wholesale tracks transactions and access products sold for external customer**, whereas there is no evidence of the prices and quantities of product purchased by TI retail and TI wholesale from Open Access. As access products are provided internally through OSS which don't keep track of the specific transactions and prices applied, "transfer charges" have to be identified and reconstructed ex-post, based on regulatory accounting[8].

- **No effective monitoring system in place**: KPI only measure lead-time within OA, not taking into account that Altnets have an additional lead-time connected to the order being processed first by TI wholesale. No KPI measuring and comparing end-to-end lead-time is available. As the delivery processes are different for internal and external customers KPIs are not able to effectively compare other elements of performances either: for instance, whereas in case of technical resources not being available in a specific local exchange, the Altnets' order gets rejected (technical KO), OA doesn't reject orders from TI retail but simply holds the order in the queue until de-saturation or resolution of the technical problem.

c) Last but not the least, **AGCOM decision 718/08/CONS itself (as acknowledged by the Draft) recognises that the voluntary undertakings have not introduced a Functional**

[8] Based on the information acquired by the Italian Competition authority in an case against TI for discrimination and technical boycotting opened in 2010, there is no formal contract in place between TI retail and OA establishing the prices/transfer charges at which Ti retail acquires the wholesale access products.

Separation in Italy: Art 16.9 of the Annex 1 of the Decision states, in fact, that "*The Undertakings will expire should the AGCOM impose a form of Functional Separation*".

As per the description of the separation provided in the Annex, besides what already mentioned in the previous paragraph, we'd light to highlight a few inaccuracies that, again, may result in providing misleading information to NRAs:

a) model of equivalence
The single delivery process has not yet been adopted but is still in a trial phase. It should be remarked, nevertheless, that although orders coming from external and internal customers should end up in the same queue and be treated on a first come fist serve basis, the New delivery Process does not approach the structural disadvantages highlighted above and connected to the fact that Altnets do not interact directly with Open Access.

b*) Governance arrangements*
It should be remarked that **the establishment of a Board of Vigilance** in charge of ensuring the respect of the undertakings, **should not be confused with governance arrangements** guaranteeing the independence of the staff and of the separate business unit that can only be achieved, as extensively explained above, through an organizational structure creating effective incentives for the staff of the separate business entity to act for the profit of that specific entity, and not of the whole vertical integrated company.

As far as the identification of measures to prevent discriminatory information sharing practices, the "Code of Conduct" adopted foresees that the monitoring of behaviour is entirely delegated to Telecom Italia's internal procedures and sanctions applied are those envisaged for disciplinary violations by the "Contratto Collettivo di Lavoro". As a result, the code has proven to be ineffective in dissuading discriminating behaviour. As an evidence of the ineffectiveness, the Italian Competition Authority has recently opened a case against Telecom Italia based on the fact that Open Access staff has provided privileged information to Telecom Italia's retail divisions.[9] Also the Vigilance Board in its Determination n. 21/2009 has recognized that there have been violations to the prohibition to exchange confidential information between TI Wholesale and TI Retail **indicating how the creation of Open Access, the sanctioning system and MbOs in place have not eliminated the incentives to discriminate against external customers**[10].

Mechanism to test effectiveness and compliance
It should remarked, besides the specific comments on KPI systems, that the undertakings have so far not proven effective in ensuring Equality of Access and deterring discriminatory behaviour by Telecom Italia. It should be noted, in fact, that the Italian

[9] See the AGCM case A426 – "TELECOM ITALIA-GARE AFFIDAMENTO SERVIZI TELEFONIA FISSA E CONNETTIVITÀ IP", available at:
http://www.agcm.it/agcm_ita/BOLL/BOLLETT.NSF/0ef77801432afc41c1256a6f004d522a/29954ba9cc5459d6c1257734002aa771?OpenDocument
[10] http://organodivigilanza.telecomitalia.it/pdf/Determinazione_n_21_2009_S0209_Chiusura_procedimento.pdf

Competition Authority has recently opened a proceeding[11] against TI for technical discrimination: the competition authority is investigating the high percentage of rejections to the orders of Alternative operators suspecting it may be part of a strategy to weaken Altnets' ability to compete and reduce the loss in market share that Telecom Italia has been suffering in the past years in retail broadband and voice markets. Again, this indicates how the incentives for the company management, including Open Access, to discriminate against Alternative Operators have not been eliminated.

4. Definition and scope of Functional Separation in art 13b of the Access Directive

Art. 13b takes into consideration situations in which an SMP operator voluntarily submits a proposal of separation. The directive foresees in this situation that the NRA assesses the impact of the proposed voluntary separation and conducts a coordinated analysis of the different markets impacted, imposing, maintaining or withdrawing obligations.

Given the procedural and substantial impact of the above mentioned procedures on the activities of the NRA and the relevant regulatory framework, **the scope of application of the above provisions should be carefully assessed, based on the wording of art 13b.**

The procedure of art 13b only applies when:

(i) the SMP operator intend to transfer their local access network assets or a substantial part thereof to a **separate legal entity under different ownership** or **to establish a separate entity**.

(ii) The provision of fully equivalent access products.

The Draft should highlight how the wording of art 13b refers to specific circumstances: the reference to the provision of fully equivalent access product indicates how the EU legislator expects the vertical integrated company to propose, at least, the creation of a separate BU ensuring fully equivalent access through equivalence of inputs. As already remarked, a separation only implementing Equivalence of outputs and the provision of "comparable" wholesale services to internal and external customers does not comply with the "*provision of fully equivalent products*" required by art 13b. The **minimum separation model that may trigger the onerous and burdensome activities described in art 13b is therefore a functional separation** (as in level 3 of Martin cave's taxonomy) **or legal/ownership one** (as in level 5/6).

Lighter forms of separation, not ensuring full equivalence of inputs, should not fall under the procedure described but treated as a declination of standard non discrimination remedies adopted by NRAs under the existing framework.

[11] See the AGCM case A428 – "WIND-FASTWEB/CONDOTTE TELECOM ITALIA", available at: http://www.agcm.it/AGCM_ITA/DSAP/DSAP_287.NSF/6bd2447e03fbb8bcc12564ac002bef5a/ee179ed3fba62e1cc1257760002bce50?OpenDocument&ExpandSection=-2

In this context, for instance, the voluntary commitments presented by Telecom Italia as a reinforcement of the internal reorganization, not involving ownership, legal or functional separation, would have definitely fallen outside the scope of art. 13b

In order to provide practical guidance to NRA, it would be advisable to suggest that NRAs activate the procedures described by art 13b, only when the voluntary proposal of separation includes the minimum elements listed in art 13a.