Telefónica comments to the Draft BEREC Guidance on functional separation under Articles 13a and 13b of the revised Access Directive BoR (10)44

Telefónica welcomes the opportunity to participate in this consultation about guidance for functional separation. As stated in the document, the aim is *to provide guidance that can be used by NRAs when considering the appropriateness and the implementation of functional separation*.

Regarding the appropriateness, we believe that FS is an extreme remedy and should be the "final" possibility when all other options have failed. There are better and less costly regulatory approaches in today's regulatory framework, to deal with non-discriminatory problems. Functional separation implies much more than a regulatory issue in search of a solution to a non-discrimination problem. It is an issue that changes the competitive model of a market, and its possible introduction implies a high level policy decision.

FS will not be the end of the story or diminish regulatory costs. NRAs will very likely need to keep regulating around the functionally separated operator. FS is not the end of all regulation problems; it is just the beginning of a different set[1].

Experiences of separation in other network industries in Europe have failed in their main objectives. The French Consultant IDATE[2] has analysed the experience of the various cases of separation that are already underway, in one form or another, in other network industries (gas, electricity and railway), particularly in France and UK. The analysis reveals that the processes led to more cumbersome and complex regulation (not more streamlined, as often promised), a levelling–off or a drop in the sector's investment, a decline in the resources allocated to R&D and a decrease in the quality of the service delivered to end customers.

Because of this, the document proposed by BEREC should try to lay down strict criteria for a possible imposition of FS, and especially to demand a careful and rigorous assessment of the costs and benefits of FS. Telefónica is of the view that the standard of proof required to take such an intrusive action should be much higher than the usual standard used in market analysis decisions by NRAs. Any statement that NRAs make sustaining their decision should be double checked, verified and objectively proved.

[1] Herrera-González F & Castejón-Martín L. (2009). The endless need of regulation in telecommunications: An explanation. *Telecommunications Policy* 33, p.664-675.

[2] IDATE: Functional separation in telecoms: panacea or plague? (March 2008)

Exceptionality of the measure

- Telefónica supports a precise application of the principle of proportionality. We welcome the inclusion of footnote 6 about the concept of proportionality, but it should probably be put in the main text and not only in a footnote. We think that for FS separation, the proportionality test will hardly be passed, given that there are always less onerous measures available, and the disadvantages are huge.

- Telefónica agrees that a "*reasonable*" amount of time will need to pass between the imposition of the obligations foreseen in Articles 9 to 13 and reaching the conclusion that functional separation is necessary. However, we think that it is also necessary to look at all the issues and details that have an influence on the effectiveness of those remedies. For example, to study if they were appropriately designed. Sometimes some wholesale products have a learning curve for both operators and regulators, and it is necessary some time and improvements to make them effective. For example, delivery times of wholesale products that are impossible to achieve may end up in disputes and problems that are out of the control of the operator.

  In some cases the existence of a track record of enforcement against the SMP operator should be seen in the context of this learning curve: an obligation of tight delivery times impossible to fulfil in practice may lead to excessive demands from alternative operators in order to profit from the penalties involved[3]. In other cases, the fact that delivery times are different at wholesale and retail does not imply a discriminatory behaviour, it may simply mean that the services cannot be provided with the same delivery times, because they are different in nature. So this track record of enforcement should be considered only if there is proof of discriminatory behaviour by the operator.

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

[3] The story of the RUO in Spain can be an example of this. As has been recorded in some EC Implementation Reports, the RUO was the subject of various conflicts and problems among operators, Telefónica and the Spanish NRA. The problem was that RUO services provisioning conditions involved several kinds of complexities, not easy to solve by interested parties, in a process that requires time and practice. Right now, problems on RUO in Spain are anecdotic, as reflected in the XV Implementation Report.

Procedures

- **Impact analysis**: the BEREC document recognises as very challenging the quantitative analysis of benefits and costs. Telefónica thinks that a rigorous and objective cost-benefit analysis is necessary before any decision is made on functional separation, as FS is an extreme measure that will have a profound impact in the way the whole sector develops in a given Member State.

  Cost benefit analysis should be done also in comparison to other less intrusive measures, i.e., the exercise should at least include:

  - What would be the costs and expected benefits of a functional separation obligation on the incumbent, and:

  - What would be the costs and expected benefits of a further development and refinement of the standard remedies of articles 9 to 13 of the AID. For example, an improved design and/or stricter enforcement.

This check would be necessary in order to fulfil the requirements of art. 13a).2d) of the AID: *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.*

And it is especially important not to forget any of the financial outlays[4] associated to separation. The BEREC document quotes the costs of separation, re-location and rebranding. These are indeed costs to assess, but there are other costs, such as those of running the different Committees and governance bodies, and those of the legal disputes that will undoubtedly arise in an imposed FS.

The unavoidable distortion in the focus of the company diverting efforts from market activities into organizational efforts will produce a lot of hidden costs.

And most importantly, we should bear in mind the costs associated with a major change of the concept of the competitive model of the country. As is recognised in page 14*: 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 telecommunications market.* This is something that cannot be evaluated in the short or medium term, but in the longer term.

[4] Bernstein Research estimates are between 100 and 300 million pounds for the BT-Openreach case.

- **Assessment of the need to impose FS**: We basically agree with the observation that says*: the imposition of such a measure should be balanced considering both the expected benefits in solving the competition problems and the costs of taking this decision. In particular, it should be compared to the situation when all other available obligations have been imposed and enforced in a consistent manner.* Telefónica thinks that current obligations to deliver services in appropriate timeframes, publishing KPIs, etc. if properly designed and enforced will be a much better tool than FS.

  That is why we consider that it is important to include in the cost benefit analysis other options, such as an improvement of the standard remedies under art. 9 to 13 AID (see above). The standard measures that already exist have proved valid in many European countries and over time, demonstrating that they can tackle competition problems and create a competitive market. A traumatic measure like FS has been less tested than the range of standard measures that NRAs are applying.

  The BEREC refers to the existence of structural barriers to entry. In this context, it must be noted that absence of alternative access infrastructures could be (and many times is) due to a regulatory model focused on promoting competition based on wholesale products, that undermines the business case of alternative infrastructures.

  It is also difficult to understand the sentence: “it will encourage investments since it gives greater legal certainty to both incumbent and new market entrants…” The problem of legal certainty will remain, as it will certainly imply a legal appeal. And, on the other hand, it will need continuous adaptation. This has been the case in the UK, where the undertakings have had to be revised due to the need to evolve the network infrastructure towards an NGAN.

- **When to determine that competition problems are important and persistent**: regarding the degree of replicability of the relevant assets, the competition from wireless platforms should be taken into account, and the BEREC document should include a reference to the recital 61 of the BR Directive also here for the purposes to assess the degree of replicability.

  The existence of viable alternative infrastructures should not only be assessed in the short/medium term, but also in the long term. As recognised by the document, FS is a difficult to reverse solution, that will last during a very long period, and then the assessment cannot be only limited to the short/medium term.

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

Impact on the undertaking and the sector: the BEREC document quotes briefly the different elements of impact. Telefónica considers that it is necessary expand this part and to take into account other elements:

- One of them is clearly the change of the competitive model of the country; see above: As in recognised in page 14*: 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 telecommunications market.*

- The only advantage stated is quite vague: the document refers to "significant gains", as operators will presumably "find the process of obtaining access more efficient" than before. This could be something also achievable under the current remedies of articles 9-13 of the AID. On the contrary, the process will lose in efficiency for a period of time, while the new structure is settled and new procedures are implemented.

- Impact on the incentives to invest: the discussion on this point is welcome and summarises the main points in a general way. We support the recognition of the fact that there are less incentives to gain independence from the incumbent through the deployment of own infrastructure. However, it is difficult to understand the sentence: *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).*

  Equivalence would lead alternative operators to invest in LLU, but it is difficult to infer that this investment would lead them to deploy its infrastructure further, and incentivise the incumbent to invest in fibre. There is very little experience up to now of unbundlers doing so. The overwhelming majority of alternative infrastructure in the EU belongs to cable operators. It is not clear why this would happen under a functional separation obligation, if it did not happen without it; in fact, it seems more unlikely.

  We welcome the point on assessment of the impact on NGA investments. It is clear that the incentives to invest in these networks by the incumbent are decreased. The industry is now on the verge of a challenging renewal that will need great amount of investment and innovation (deployment of Optical Fibre for New Generation Access Network, NGAN). Innovation in customer services is not possible without innovation in the network. At present uncertainties in technology and demand makes it impossible to decouple customer innovation from network innovation as it would happen if services and access network would be set apart in different entities.

- Impact on consumers: From our point of view this criterion is the most relevant in this context, and this analysis should be done with care. The document quotes two elements: prices and innovation:

- In terms of prices, it is necessary to analyse if the added costs outweigh the increased competition, which may be highly uncertain with regard to the current competitive situation in most countries.

- In terms of innovation, the retail offers are going to be more uniform, as they will rely more on a single network, and competition will mainly turn around price rather than around higher capacity or new services. The lower business case for alternative infrastructures will decrease the range and quality of the offers available. And the lower deployment of alternative infrastructures implies that there are fewer incentives to invest in NGAs.

- The draft guidelines point out that NRAs should assess the impact of FS on issues such as "workforce" or "social and territorial cohesion", Telefónica agrees with the need of this analysis, but thinks that NRAs are probably not the best placed to carry out such analysis, when they are not supposed to be experts in those areas. The effects of a FS would go well beyond the scope of the telecommunications sector. Because of this, the analysis required can not be accomplished only by a telecom NRA.

Contents of the draft measure

Some of the elements that are identified in this chapter can also be performed without resorting to functional separation. In fact, we think that the most important elements to guarantee non-discrimination can be performed under the standard remedies: indicators related to delivery and assurance processes, availability of the network elements and services, product equivalence, behavioural metrics, publishing key performance indicators and reports about whether these have been met, publication of reports on complaints received, rules for ensuring transparency of operational procedures, etc.

Other elements of the draft measure just reflect the complexities and costs that functional separation can imply, for example: point b) implies a detailed inventory of assets (tangible and intangible) to define the perimeter of the separated company, creation of compliance body, and independent board, or a compliance officer.

This contents part reflects the complexities of functional separation and the fact that the separation process does not lead to regulatory simplicity or legal certainty as has been sometimes claimed.

Annex

Telefónica finds not fully objective the analysis made in Annex I for the case of UK. Relevant evidence is not shown in that description, including doubts stated by the same OFCOM. (Examples: problems at the beginning of the process with the quality, actual investment in NGNs, comparison with penetration in other countries, prices; the discussion about rising prices in UK, BT financial situation, no reference to costs, the need to review the undertakings for NGA deployments,…) Overall, the annex seems to want to convey the impression that FS has been a complete success in UK, when there are evident signs that the case is not so clear.