Separation versus Regulation:

A broader perspective

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The opinions expressed are solely those of the author.

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Separation versus regulation: A broader perspective

- Functional Separation: Why?
- Functional Separation: How?
- Using the right tool for the right job
- The scope of separation
  - Geographic scope
  - Symmetric versus asymmetric aspects
- Separation and investment (in fast broadband)
- Institutional arrangements
- Concluding remarks

Functional separation: Why?

- Separation has its roots in competition economics.
- With *vertical foreclosure*, a firm with market power in one market segment attempts to project that market power into upstream or downstream market segments that would otherwise be competitive.
- By structurally severing the connection to the upstream or downstream activity, the incentive to foreclose is eliminated.
- With structural separation, no enforcement is needed; thus, much complexity is avoided.

Functional separation: Why?

- *Structural separation* is felt to be an extreme solution that sacrifices the firm‘s efficiencies of scale and scope.
- *Functional separation* is an attempt to achieve the benefits of structural separation, but without structurally separating the firm, and thus without losing all of the efficiencies of integration; it thus represents an attempt at a compromise.
- Enforcement, however, is no longer so simple.

Functional separation: Why?

- Separation eliminates the incentive to favour the firm‘s own affiliated activity over those of competitors.
- Separation thus
  - eliminates incentives to discriminate, and
  - makes it much easier to identify discriminatory conduct.
- These are important achievements. Nondiscrimination can be very challenging to monitor and enforce.
- In and of itself, however, separation does nothing to ensure, for instance, that prices are reflective of underlying costs.

➢ Separation consequently does not, by itself, eliminate the need for all regulation.

Separation: How?

Ownership separation (in whole or part)	
6	Legal separation (separate legal entities under the same ownership
5	Business separation with separate governance arrangements
4	Business separation with localized incentives
3	Business separation (BS)
2	Virtual separation
1	Creation of a wholesale division
Accounting separation	

Source: Martin Cave (2006), Six Degrees of Separation: Operational Separation as a Remedy in European Telecommunications Regulation

Separation: How?

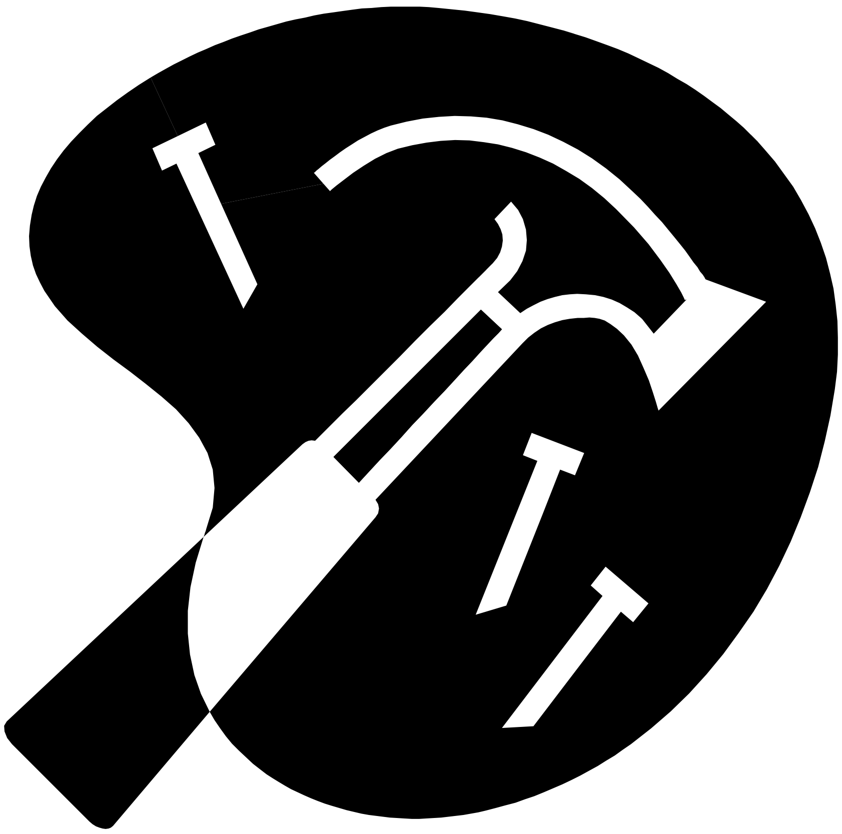
- Many forms are visible worldwide:
  - UK: “voluntary” separation of last mile (but under threat).
  - United States: local versus long distance separation.
  - Sweden: wholesale/retail fibre last mile separation.
  - New Zealand: imposed wholesale/retail last mile separation, followed by voluntary structural separation.
- In Europe, separation has never been imposed by the regulator, but has sometimes been a response to a threat.

Voluntary separation in Europe

- Article 13a (mandatory separation) has never been invoked.
- Article 13b (voluntary separation) requires an SMP operator to inform the NRA in advance "… when they 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 business entity in order to provide to all retail providers, including its own retail divisions, fully equivalent access products …" so that the NRA can determine whether any remedies should be maintained, lifted, or altered.

The right tool for the job?

- Separation is well suited to ensuring nondiscriminatory access to last mile facilities of a single fixed network SMP operator.
- For other goals, other instruments may be more appropriate.
- “If all you have is a hammer, everything looks like a nail.”
- What else needs to be dealt with?



Relevant only to Telecom Italia?

- In general, we worry about nondiscrimination only for firms that possess SMP on a relevant market.
- For foreclosure to occur, there must be market power that could be projected.
- For Italy as a whole, dependence on Telecom Italia continues to be strong.
- This dependence is compounded by the total absence of cable television.
- If there were issues, they would have to flow from:
  - Bottlenecks that do not depend solely on market power;
  - More localised market power.

Geographic market delineation

- Market analysis has routinely been done at Member State level, and the Commission argues that competitive constraints often have nationwide effect.
- NGA markets are clearly more “patchy” than historic copper markets.
- Sub-national markets face a high burden of proof.
  - Sub-national market analysis (e.g. Ofcom) is extremely resource-intensive.
  - Sub-national application of remedies (e.g. Austria) is less work, but perhaps less robust.
- This is a not altogether settled area at present.

Asymmetric versus symmetric obligations

- The European framework has emphasised asymmetric access regulation of a single SMP operator since 2003.
- Other obligations apply, however, to all network operators.
- Symmetric regulation of the “first mover” might make sense in specific instances:
  - Building wiring for NGA (cf. ARCEP).
  - Vectored VDSL.
- This seems in principle to be a promising model for Italy.
- The relationship between symmetric and asymmetric access regulation is yet another area where European regulatory practice is still evolving.

Separation versus investment in fast broadband

- Mixed evidence on the impact on fast broadband deployment.
- For the incumbent, incentives are arguably reduced, transaction costs are arguably increased.
  - Some have argued that functional separation slowed the deployment of fast broadband in the UK (which however seems to be proceeding well today).
  - Similar arguments were put forward in the US.
  - In New Zealand, VDSL deployed well despite separation.
  - In Sweden, structurally separated municipal fibre networks appear to function well.

Infrastructure sharing arrangements

- Infrastructure sharing arrangements can avoid duplication of investments, thus reducing costs for network operators.
- In the Caio Report, we encouraged increased use of infrastructure sharing (but with due regard for competition) in order to promote faster broadband deployment.
- Infrastructure sharing implies sharing of information, and may undermine competition.
- The impact on firms excluded from sharing arrangements needs to be considered.
- Overall, more infrastructure sharing in Italy would probably be in order, but in each case the facts must be examined.

Institutional arrangements

- In the UK, and in New Zealand, an Equivalence of Input Board was established to monitor the SMP operator‘s compliance with its nondiscrimination obligations.
- The OdV appears to be properly constituted to do so for Telecom Italia.
- When it comes to monitoring other network operators, however, or for other kinds of regulatory compliance, the OdV seems not to have the right structure or competences.
- This would seem to imply for that for any symmetric obligations (e.g. on VDSL), the OdV is at most a part of a broader solution.

Concluding remarks

- Separation can serve as a powerful instrument for dealing with the challenging problem of nondiscriminatory access to last mile facilities.
- It must however be seen in its broader context – it is *one* tool out of many.
- Analogously, the OdV's role needs to be understand as that of one institution out of many.

References

J. Scott Marcus, Dr. Christian Wernick, Kenneth R. Carter (2009), “Separation of Telstra: Economic considerations, international experience”.

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