

# Functional and Structural Telco Separation: European and Australasian Developments

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Many regulators are keeping a close eye on separation initiatives internationally, often sharing ideas with each other. Incumbents and other stakeholders should be watching this space proactively too. The EU last week confirmed a new separation framework. The closely-watched Australian initiative continues to develop. New Zealand, with its functional separation model, has a major new decision, and issue of court proceedings by the regulator against the incumbent.

## Europe

The European Parliament has approved a number of changes to the EU Telecoms Framework<sup>1</sup>, including new rules on functional<sup>2</sup> and structural separation (FS and SS respectively).<sup>3</sup>

As expected, the national regulatory authorities (NRAs) in each EU country can implement FS only in:<sup>4</sup>

exceptional cases....where there has been persistent failure to achieve effective non-discrimination in several of the markets concerned, and where there is little or no prospect of infrastructure competition within a reasonable timeframe after recourse to one or more [other] remedies

The approach focuses on separating out a wholesale business unit, responsible for supplying access products to all undertakings including the Telco itself. Supply terms for both external and internal customers follows the equivalence of inputs approach (the same price and non-price terms and processes including for the Telco's own retail operations).

To implement FS, the NRA must, among other things:

- seek to preserve incentives to invest, and consumer welfare;
- undertake a coordinated market analysis of the different markets;
- consider the impact of fixed and mobile substitution as well as which products fit in each business unit, the extent of network roll-out, and other technology developments;
- consider the interests of affected Telco employees;
- obtain approval in advance from the Commission; and
- enable coordination between each separated business unit so that the economic and management supervision rights of the Telco are protected.

<sup>1</sup> The text prior to formal adoption is at [http://ec.europa.eu/information\\_society/policy/ecomm/library/proposals/index\\_en.htm](http://ec.europa.eu/information_society/policy/ecomm/library/proposals/index_en.htm).

<sup>2</sup> i.e. separation of the Telco into two or more business units, with equivalence/non-discrimination rules, where the business units are still owned by the Telco. Sometimes also called operational separation. There is a wide range of degrees of functional separation ranging from the current separation of Telstra, through to the separation of the UK's BT and New Zealand's Telecom.

<sup>3</sup> i.e. separation where a part of the business is transferred into ownership separate from the original Telco. For example, the network may be sold into a new company floated on Stock Exchange markets. Structural separation has been regarded as much harder to do than the separation of other utilities such as electricity utilities, in part because there is not a clear demarcation between, for example, the network and other elements of the Telco's business.

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All in all, quite a series of hurdles before an NRA can impose FS. The last point highlights the tricky, and complex, tension between the Telco retaining a measure of control while having its business units and operations separated.

Voluntary SS of its network by a Telco gets attention too. The NRA should assess the impact of the SS, and impose, maintain, amend or remove existing regulatory obligations accordingly. This of course recognises the potential pro- and anti-competitive implications of SS.

## Australia

The Australian Government planned to pass its controversial telecoms legislation, relating particularly to incumbent, Telstra, in 2009. This will not now happen until February 2010 at the earliest.

The draft legislation opts for a two business unit FS model, not the three business units in the UK and NZ models.

By a combination of controversial mechanisms, the legislation, if passed, seeks to encourage, but not force, Telstra to structurally separate not just functionally separate. That separation includes divestiture of Telstra's media-related interests (its interest in a Pay TV provider, and its interest in a cable (HFC) network). If Telstra does not go along with the government's preferred course, it also faces the prospect of not getting spectrum released from the digital dividend. Telstra has rolled out a new mobile network, and new spectrum for LTE is of course very important.

Regulators watch developments in Australia closely.

## New Zealand

New Zealand picked up its own variation of the BT Undertakings FS model. It's now been in operation for over 18 months.

The model has an Independent Oversight Group (IOG) which is similar to the BT Equality of Access Board (EAB). These bodies (made up of members from the incumbent and members who are independent) monitor compliance with the FS undertakings. In the case of the IOG, the role is largely monitoring and reporting. The telecoms

regulator (the Telecommunications Commissioner) has the enforcement powers.

In 2008/2009, the incumbent – Telecom – made three overlapping “Loyalty Offers”. In short, if a wholesale customer agreed to acquire a certain percentage of its bitstream and other specified wholesale access services from the separated Telecom Wholesale business unit, it would be able to acquire the services at a lower price than the regulated wholesale price. It was argued, against Telecom, that the effect of this was to discourage other providers from investing in unbundling local loops, thereby reducing infrastructure-based competition.

This is an issue that goes to the heart of FS: is there non-discrimination and equivalence of inputs?

Much hinges on the words of the undertakings as well as the underlying policy.

The IOG, in its monitoring and reporting role, decided that Telecom, in offering this differential “loyalty” pricing, would breach both:

- a) the generic non-discrimination provision in the Undertakings; and
- b) the interim Equivalence of Inputs undertaking.

In a draft report, the regulator has come to the same conclusion. Prior to finalisation of that report, the regulator has issued enforcement proceedings against Telecom on the non-discrimination limb of the allegations. As Telecom withdrew the loyalty offers after the IOG's decision, it appears that the regulator will seek pecuniary penalties to be paid by Telecom, due to the alleged breach.

These developments inform, and will continue to inform with each change, the international debate on separation.

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