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European Commission launches consultation on State aid and regulatory strategy to promote high speed Internet

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By Kees Jan Kuilwijk and Michael Sánchez Rydelski

Introduction

On 26 November 2008, the Commission adopted a “European Economic Recovery Plan”¹ as a means to drive Europe’s recovery from financial and economic crisis. One of the key pillars of the Recovery Plan rests on “smart” investments into infrastructure and inter-connection to promote efficiency and innovation. An important component is the “broadband strategy”.

The broadband strategy aims at achieving 100% high speed internet coverage for all citizens by 2010. To achieve this goal large sums of private and public money² will need to be injected in the coming years.³ In order to facilitate this process and enhance legal certainty for stakeholders, in terms of financing and operating broadband networks, the Commission has published two documents:

- Draft “Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks” (hereinafter “draft Guidelines”).
- A draft “Commission Recommendation on regulated access to Next Generation Access Networks (NGA)” (hereinafter “draft Recommendation”).

The draft Guidelines intend to clarify the limits that EU Member States must respect when providing State aid (i.e. national subsidies) to the deployment of broadband networks. The draft Guidelines address separately the funding of Next Generation Access (NGA) networks deployment. The deployment of such networks represents a major technological shift in the broadband market and the Commission aims to encourage and support the rapid and timely roll-out of such networks.

1 Communication from the Commission to the European Council, COM (2008) 800: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0800:FIN:EN:PDF>

2 The Commission already decided to earmark EUR 1 billion to help rural areas to get online.

3 Rolling out these networks across the EU will cost an estimated EUR 200 to 300 billion.

The draft Recommendation provides guidance to national regulators in the EU on the regulatory approach to be taken and to further stimulate the broadband strategy.

Both documents were launched for public consultation. The consultation period for the draft Guidelines ended on 22 June 2009. The results of the consultation will soon be published on the Commission's website.⁴ The consultation period for the draft Recommendation expires on 24 July 2009.

On the basis of the comments received the Commission will finalize and adopt these documents later this year.

The Draft Guidelines

On 19 May 2009, the Commission published the draft Guidelines.⁵ The draft Guidelines attempt to strike a balance between, on the one hand, allowing State aid for the deployment of broadband networks in areas where private companies are not investing or coverage is inadequate, and, on the other hand, not using State aid to crowd out investments by existing operators.

State Aid to Traditional Broadband

The draft Guidelines first summarize the Commission's policy and past practice on individual cases of State measures to support "traditional broadband" deployments. During the last couple of years, the Commission has adopted more than 40 decisions in individual cases and has thereby gained considerable experience in this sector.

The draft Guidelines explain that in two cases State aid may be excluded at the outset, namely: (1) if the State acts like a market economy investor (for example in situations where the State provides for an equity participation or capital injection into a company that is to carry out the project);⁶ or (2) if the States compensates for public service obligations and if this compensation fulfills the "Altmark criteria".⁷

⁴ Link: http://ec.europa.eu/competition/consultations/2009_broadband_guidelines/index.html

⁵ The draft Guidelines are available at: http://ec.europa.eu/competition/consultations/2009_broadband_guidelines/guidelines_en.pdf

⁶ Commission Decision of 11 December 2007 in case C 53/2006 *Citynet Amsterdam – investment by the city of Amsterdam in a fibre-to-the home (FTTH) network*, OJ 2008 L 247, p. 27. As underlined in this decision, the conformity of a public investment with market terms has to be demonstrated thoroughly and comprehensively, either by means of a significant participation of private investors or the existence of a sound business plan showing an adequate return on investment.

⁷ These criteria were laid down by the ECJ in Case C-280/00 *Altmark Trans GmbH* [2003] ECR I-7747. In two broadband decisions the Commission concluded that the Altmark criteria were fulfilled: Commission Decision N 381/2004 – *France, Project de réseau de télécommunications haut débit des Pyrénées-Atlantiques*, and Commission Decision N 382/2004 – *France, Mise en place d'une infrastructure haut débit sur le territoire de la région Limousin (DORSAL)*.

If, however, none of these two scenarios are applicable, the State funding will involve State aid, which is subject to a notification requirement to the Commission. The Commission will then assess whether the aid can be approved. In the assessment process the Commission's methodological and analytical approach is based upon the distinction between areas that lack broadband connectivity (white areas), areas where only one network infrastructure is deployed (grey areas), and areas where at least two competing broadband infrastructures are present (black areas).

Whereas the approval of State aid in white areas is usually unproblematic, the Commission takes a more restrictive approach to grey and black areas. In black areas the Commission will generally view negatively measures funding the roll-out of an additional broadband infrastructure.

On the other hand, State aid for the deployment of broadband networks in grey areas is possible, but requires a more detailed analysis. The Commission will consider as positive elements for approving the State aid:

- If a detailed mapping and coverage analysis (market analysis) was carried out to minimize distortion of competition.
- If an open tender process was conducted for the project.
- If the best economic offer was selected, in order to minimize the State aid amount.
- If Member States, in principle, are not favoring any particular technology or network platform.
- If bidders have recourse to existing infrastructure, in order to avoid duplication.
- If possibilities of wholesale access are provided, which would allow third party operators to compete with the selected bidder (when the latter is also present at the retail level).
- If a benchmarking pricing exercise was conducted, in order to avoid excessive wholesale prices.
- If a claw-back mechanism was set-up to avoid over-compensation and to oblige the selected bidder to reverse payments to the State, if demand for broadband in the target area grows beyond anticipated levels.

State Aid to NGA Networks

The draft Guidelines then turn to the public funding of NGA networks. NGA networks are access networks which consist wholly or in part of optical elements and which are capable of delivering broadband access services with enhanced characteristics (such as higher throughput) as compared to those provided over existing copper networks. The Commission notes in the draft Guidelines “...that novel products or services which are not substitutable from both demand and supply side perspectives may emerge and will require broadband speeds in excess of the upper physical limits of basic broadband infrastructure.”⁸

Although the Commission qualifies NGA networks as separate markets, it will also look into the effects of aid on existing broadband networks given the degree of substitution which appears to exist.

The Commission’s proposed methodological and analytical approach concerning NGA networks is based upon the existing distinction between white areas, grey areas and black areas. Accordingly, an area where NGA networks do not at present exist and where they are not likely to be built and be fully operational in the near future⁹ should be considered to be “white NGA” areas. In white NGA areas where one basic broadband network already exist (traditional grey area), the grant of aid will be subject to the following two conditions: (1) Member States would have to demonstrate that the existing network is insufficient to satisfy the needs of citizens and business users, and that (2) there are no less distortive means (including ex ante regulation) to reach the stated goals.

With regard to grey NGA areas, the Commission will look additionally at whether:

- The overall market conditions are not adequate, by looking, inter alia, into the level of current NGA broadband prices, the type of services offered to residential and business users and the conditions attached thereto and whether there exists, or is likely to appear, demand for new services that cannot be met by the existing NGA network;
- effective network access is not offered to third parties or access conditions (regulated and unregulated access) are not conducive to effective competition;
- overall entry barriers preclude potential entry by other NGA network investors;

⁸ Paragraph 62 of the draft Guidelines.

⁹ The term “in the near future” should correspond to a period of 5 years.

- the NGA network already in place was built on the basis of a privileged use/access to ducts¹⁰ not accessible by or shared with other network operators;
- any measures taken and/or remedies imposed by the competent national regulatory or competition authority with regard to the existing network provider are not able to overcome such problems.

The Commission sees no need for State aid in black NGA areas. Equally, in traditional black areas (basic broadband), the Commission would, in principle, not endorse further State intervention, if operators have the intention to upgrade their traditional broadband networks.

Finally, in relation to NGA networks, the draft Guidelines provide for additional safeguards to limit distortions of competition, such as: enhanced wholesale access for third parties for at least 7 years; conditions for wholesale network access should be established in consultation with National Regulatory Authorities; point-to-point “multiple fiber” architecture or an architecture that can be unbundled; the aid should not cover the last mile access segment, in cases where operators already provide advance basic broadband networks.

The Draft Recommendation

On 12 June 2009, the Commission launched the public consultation on its draft Recommendation.¹¹ According to the Commission, this consultation will help to ensure that the Recommendation provides the necessary legal certainty to encourage large scale investment in new fiber infrastructure for very fast broadband internet services while safeguarding effective access to NGA networks for competitors.

A previous public consultation held during the fourth quarter of 2008 confirmed general support for the objective of the Commission to achieve a common regulatory framework for NGA in order to foster timely investment in very high speed networks while ensuring that the competitive structure of the market is maintained. In the light of comments from stakeholders, the revised draft Recommendation includes mechanisms to allocate the investment risk between investors and operators seeking access to NGA networks.

¹⁰ “Duct” means an underground pipe or conduit used to House (fiber, copper or coax) cables of either core or access networks.

¹¹ The draft Recommendation is available at: http://ec.europa.eu/information_society/policy/ecomm/doc/library/public_consult/nga/dr_recomm_nga.pdf

Broadband access is currently regulated by national telecoms regulators. The objective of the Commission's Recommendation will be to foster the application of consistent regulatory remedies to dominant NGA operators, in order to prevent them from leveraging their dominant position to new broadband services markets.¹² The draft Recommendation is therefore mainly "asymmetric", i.e. rules are imposed only on dominant operators with significant market power. In general, the Commission considers the facilitation of infrastructure competition as the preferred regulatory option. An efficient remedy would be to ensure a cost orientated non-discriminatory sharing of legacy physical infrastructure.

In most cases, however, the deployment of parallel fiber networks is not viable because no ducts are available or because the population density is too low for a sustainable business model. In such cases, access to other passive elements (unbundling of the fiber loop) or access to active elements ("bit-stream") should be mandated.

The Commission recognizes the risk involved in certain NGA investments and the need to properly allocate it between access seekers and providers in order to foster investment in fiber. The draft Recommendation, therefore, includes mechanisms to allocate investment risk between investors and access seekers. In particular, to foster market-driven investment outside densely populated areas, the draft Recommendation defines conditions under which co-investment schemes could be deemed pro-competitive.

Comments

The Commission's broadband strategy seems overly ambitious with regard to the envisaged timeframe. Deploying the necessary infrastructure will take time and will be demand driven.

Whether the draft Guidelines will contribute to the rapid roll-out of such networks is questionable. The draft Guidelines merely summarize the conditions of past Commission cases and apply these to NGA networks. The consultation of stakeholders might result in a more refined final version modeled closer to economic and technical realities. Additionally, with regard to the promotion of NGA networks, the scope of the draft Guidelines raises some questions. The current wording of the Guidelines suggests that NGA wireline broadband is favored and that wireless mobile technology is excluded. Such an approach would contradict the technology neutrality principle and would distort markets where both wireline and wireless broadband exists.

¹² Pursuant to Directive 2002/19/EC of the European Parliament and of the Council, OJ 2002 L 108, p. 7.

The draft Recommendation seems to lack a more targeted regulatory approach which would actually encourage the deployment of new networks. As the European Telecommunications Network Operators Association has noted, “...*simply extending current access rules defined for legacy copper-based networks to new high speed networks will not accelerate risky investment in the new access networks*”.

It will be interesting to watch how the public consultation process will shape the content of the final documents.

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