

## **ACT Comments on draft Communication on State Aid and Public Broadcasting**

### **Introduction**

Before proceeding to a line-by-line analysis of the Commission proposal, we would like to make some general remarks.

1. First, since the previous round of consultation, the global economic turmoil has led governments to become much more active participants in some economic sectors previously reserved to the private sector (banking, car manufacturing – maybe others). This increased appetite for state intervention and nationalisation in certain strategic sectors means that the EU rules on state aid are more important than ever to ensure that the present political climate (in which state intervention appears more “fashionable” than for many years) does not give governments unfettered discretion to intervene in all sectors. Objective, rigorous interpretation of the existing state aid rules is necessary to ensure that the interests are safeguarded of those private sector operators such as media companies who are not seeking state support, but who are competing against operators who do benefit from state resources.
2. Continuing developments in state aid in the media sector show that the Commission is right to review the 2001 framework:
  - Changing methods of supporting pubcasters (notably the tax on private broadcasters proposed in the current French reform of the sector);
  - Changing claimants for public support (Channel 4 in the UK, TV2 in Denmark);
  - evidence that structural weaknesses in supervision in one Member State can also affect competition in other Member States (see our comments on para 61 below).
3. State aid law has also evolved considerably since 2001. While it would be impossible to synthesise all the Court and Commission decisions in one Communication, the general principles of the new case-law should certainly be brought into the new Communication.
4. Our overall view is that the new Communication is a modest improvement on the existing text, as it clarifies Member States’ scope for intervention in new media markets and does so in a more helpful manner than the alternative of adjudicating on a number of individual cases (though there will continue to be cases filed). But the draft Communication is also a serious missed opportunity. Doubtless because of the intense political pressure from a number of Culture Ministries which are

very close to their public broadcasters, the Commission appears to miss three important points:

- a. despite the centrality of questions of public service mission to this debate, the Communication is almost silent on questions of remit;
- b. the need for regulation to be not just independent but also systematic and economically refined is insufficiently emphasised;
- c. most importantly, there is a lack of detail in key passages of the Communication which do nothing to alleviate the legal uncertainty of Member States and of operators, including state-aided broadcasters, as to the acceptable parameters of state intervention in the media sector. The lack of detail is also not in the interests of the European Commission. The more grey areas left in the Communication, the greater the likelihood of further complaints being filed by commercial operators.

While there are legitimate restrictions on the EU's competence to act in each of these areas (though these restrictions are perhaps not as severe as many Culture Ministries and state-aided broadcasters claim), it is not unreasonable to ask that DG COMP revisited the draft Communication to include some best practice guidance on these issues.

The new Communication must provide a technically improved instrument for the economic assessment of future and current public funding practices, in the light of the present status of public accountancy rules and principles, and always bearing in mind that the main objective of such assessment is to attain the so called competitive neutrality: the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities – public businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.

## **COMMENTS on COMMISSION DRAFT COMMUNICATION**

### **Section 1: Introduction and Scope of the Communication (paras 1 to 9)**

No particular comments. This section is factual and rather neutral, though it certainly underestimates the scale of the upheaval facing the media sector. While media companies remain confident that fundamentals of our business model remain sound, the private sector is confronted by a range of challenges, some cyclical (economic downturn hitting adspend and market sentiment) others structural (need to move beyond broadcast-only distribution, advertising market mature).

However the issue of competition between business ventures (totally depending on market revenues) and publicly funded undertakings which are only marginally sustained by the market, leaves room for some serious doubts and concerns towards possible economic downturns for some weaker players.

As previously pointed out (in ACT's March 2008 submission), many facets of public/private competition were legacies of the monopoly era of television: vague remits, lack of independent regulation, overcompensation. Contrary to what is often alleged, nobody is calling for EU pubcasting to be marginalised to an analogue ghetto

– but better co-operation between EU and national regulators is essential to ensure value for money for European taxpayers and to guard against distortions of broadcast competition being extended to new media.

## **Section 2: the role of public broadcasting (paras 10 to 20)**

We do have one question on paragraph 11 where a reference is added to Article 10 of the European Convention on Human Rights. Given that Article 10, and the safeguards relating to the independence of broadcasters, apply equally to public and private broadcasters, it is hard to see the relevance of this reference in a Communication which is concerned with respect for competition law. Indeed, there is a danger that this reference will be abused by those who seek to question the right of independent regulators to scrutinise activity of state-financed broadcasters.

It is understood that DG Competition has limited powers over remit. But this issue cannot be avoided as DG Competition's powers to check for overcompensation were undermined by meaningless (as opposed to "wide") remits and by a lack of cost allocation if all costs were deemed "public service". It was interesting to note the suggestion from the European consumers at a recent European Parliament hearing that the Commission should consider an excessively wide definition as a manifest error. This idea is, at the very least, worthy of further exploration.

Separate accounting and allocation of fixed costs work well in other areas of EU law and could usefully be applied here (especially in markets where an inversion of the net cost principle means the pubcaster reports annually on whether it had spent all the money it had received). The current situation leads directly to distortions on the programming, audiovisual rights markets and, in dual-financed systems, advertising markets. There are high-profile examples of this, particularly in the area of sports rights, where public broadcasters act, when buying rights, very far from the "market economy investor principle". For example, in the Spanish market, the Spanish pubcaster RTVE has acquired, using public money, sports rights for major sport events (Motorbike World Championship, Olympic Games, UK Premier League, Italian League, Tennis Masters Series and Champions League), for a price much higher than the market price, leaving the private broadcasters out of the bid, unable to pay such an amount of money.

It may also be pertinent to remember the precise words of the 1997 Green Paper on the Convergence<sup>1</sup> on the role of Public Service Broadcasting:

« if state funds intended to support a public broadcaster in fulfilling its public service mission were used to leverage and cross-subsidise these new activities or the use of new technological platforms, such as the internet, then such practices would be subject to the Treaty rules on competition and on the freedom to provide services.»

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<sup>1</sup> Green Paper on the Convergence of the Telecommunications, Media and Information Technology Sectors, and the Implications for Regulation, Towards an Information Society, E.C. Brussels, Belgium 3 December 1997, page 72

### **Section 3: The Legal Context (paras 21 to 24)**

The text should expand on the references to the ongoing State Aid Action Plan, a major reform policy of which this Communication plays an important part, as follows:

- The aim of such Plan is to present a comprehensive and consistent reform package based on the following elements: less and better targeted state aid; a refined economic approach; more effective procedures, better enforcement, higher predictability and enhanced transparency; a shared responsibility between the Commission and Member States: the Commission cannot improve state aid rules and practice without the effective support of Member States and their full commitment to comply with their obligations to notify any envisaged aid and to enforce the rules properly.
- The Commission will continue to develop criteria to fulfil its assessment of aid compatibility, in particular through analyses of specific sectors. In general, the positive impact of an aid depends on: i) how accurately the accepted objective of common interest (whether social, regional, economic or cultural) has been identified, ii) whether state aid is an appropriate instrument for dealing with the problem as opposed to other policy instruments and iii) whether the aid creates the needed incentives and is proportionate. On the other hand, the level of distortion created by an aid generally depends on: i) the procedure for selecting beneficiaries and the conditions attached to the aid, ii) characteristics of the market and of the beneficiary and iii) the amount and type of aid.
- An economic approach is an instrument to better focus and target certain state aid towards the objectives of the re-launched Lisbon Strategy. Making more use of a refined economic approach is a means to ensure a proper and more transparent evaluation of the distortions to competition and trade associated with state aid measures. This approach can also help investigate the reasons why the market by itself does not deliver the desired objectives of common interest and in consequence evaluate the benefits of state aid measures in reaching these objectives.

### **Section 4: Applicability of Article 87(1) (paras 25-36)**

No particular comments – the analysis on the state aid character of pubcaster funding is helpful if, by now, uncontroversial. Paragraphs 110-111 from Case E-8/2006 (Belgium) could usefully be quoted here on the subject of acquisition and sale of programme rights, which often takes place at an international level

We do have a concern on new/existing aid where we feel the Commission is too generous in allowing the fact that there was some state aid to analogue broadcasting in place at the time of the Treaty coming into force to cover a multitude of new aid schemes to new media. The RTVE Case is a clear example of this.

## **Section 5: Assessment of the Compatibility of State Aid under Articles 87(2) and 87(3) (paras. 37-40)**

We agree with the Commission that 87(3)(d) should not normally be relevant in these cases.

## **Section 6: Assessment of the Compatibility of State Aid under Article 86(2) (paras 41-106)**

As regards the introductory text of Section 6, ACT suggests that the new Communication puts emphasis on the fact that, under Article 86(2) EC, it is for the Member States to demonstrate that the conditions laid down in that provision are satisfied. This aspect is already reflected – albeit less explicitly – in paragraphs 48 and 70 of the draft Communication.

ACT suggests that § 43 be re-worded as follows:

"It is for the Commission, as guardian, of the Treaty, to assess whether these criteria are satisfied.

However, at the same time it should be recalled that, in the context of Article 86(2) EC, it is incumbent on the Member State or the undertaking which seeks to rely on that provision to show that the conditions for application of that provision are fulfilled (Case C-126/06, *International Mail Spain*, paragraph 49, and Case C-340/99 *TNT Traco*, paragraph 59). In the absence of sufficient and reliable indications that those conditions are satisfied, the Commission would not be able to carry out its task under Article 86(2) and, therefore, could not grant any exemption under that provision".

### **6.1 Definition of Public Service Remit (paras 45 ff)**

As we mentioned above, the question of when a “wide” remit becomes a “meaningless” one designed to frustrate the Commission in its tasks under the Treaty and therefore potentially a manifest error, should be explored.

The ACT would like to make three main comments: on manifest error, on application to new media, and on linkage to dual financing. We would also take this opportunity to cross-refer to our comments about the central role of the remit issue from our March 2008 paper.

#### **(a) Manifest Error**

While it may appear positive that Teleshopping has been added to the examples of manifest error ( § 47), as has viewers’ participation in a prize game by dialling a premium rate number, also, in § 54, in fact there is little evidence that these are being viewed as significant revenue sources for many public broadcasters around Europe. So the practical impact of these entirely sensible additions from the Commission may be minimal.

Excessively wide definitions, where all and any kind of programme and genre are included within the public service remit, without reference to any quantitative percentages, and also by all new medias, may be seen as a manifest error.

(b) Application to New Media

Online activities offered by the public service broadcaster (e.g. chat rooms, online games, calculators, links to third parties offers/services) can only exceptionally constitute services of general economic interest, since the Amsterdam Protocol refers only to broadcasting and, depending on the circumstances, they may lack specific features as compared to other similar or identical already offered by the market. At the very least, a link to programme (programme-related, programme accompanying, media services) is essential to determine whether new services satisfy the same democratic, social and cultural needs as traditional television.<sup>2</sup> Special vigilance may also be required to verify whether other similar or identical services already exist.

(c) Linkage of remit to dual financing:

Public service remit definition being a prerequisite for a proper legal framework, this issue still requires more attention to be devoted in the revised Broadcasting Communication.

A flawed and overly broad definition of the public service remit entails significant risks for competition, in particular, where the public service broadcaster is dually financed (though low dependency on commercial income is not in itself a reliable indicator for a programme to contain more “public service value”).

Moreover, where the definition of public service remit includes “empty” requirements, it does not allow the competent authorities at the Member State level and the European Commission to effectively monitor or supervise pubcaster’s compliance with the principles of SGEI.

By contrast, the definition should involve the Member States establishing a precise list of activities (both in terms of content and quantification) that form the public service remit.

When defining the PSB, for example, the following elements should be taken into account as a reference: (i) existing commercial programming, (ii) focus on European and national cultural industries, (iii) rationalisation of the number of TV channels that are really necessary to fulfil the PSB remit, especially regarding the increase of the TV supply/offer as a consequence of the DTT.

Quoting a 2005 Study from UNITEC New Zealand, School of Communication<sup>3</sup>:

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<sup>2</sup> See Case E-3/2005 (Germany) paras 232-235

<sup>3</sup> Mechanisms for Setting Broadcasting Funding Levels in OECD Countries – Research and Analysis Project Report Prepared for Te Manatu Taonga/ Ministry for Culture and Heritage December 2005, UNITEC, New Zealand School of Communication, page 170-171

“(...) audience share is a zero sum market. Therefore, any level of audience share gained by the public service broadcaster may be perceived as revenue denied to the commercial operators.

Consequently, public funding mechanisms may be challenged by the commercial broadcasting lobby if they are deemed to facilitate the PSB’s engagement in direct competition for audiences.

(...)

Where the public broadcaster does compete directly for audience share and advertiser revenue, commercial operators have an arguably stronger case for contending that the availability of public revenue distorts the market and provides the PSB with an unfair commercial advantage.

Particularly in cases of PSB’s which depend on both public and commercial revenue, public money cannot be said to be used only to compete for quality, because audience share is needed to attract revenue. If public money is used to acquire or produce content which then generates audience share and commercial revenue, commercial operators may claim there is a “double funding” system at work which unfairly increases the PSB’s ability to compete for revenue. Although the EBU has rejected this line of criticism, in cases where the PSB uses public money to, say, outbid rivals *for* commercial programming rights or to produce imitative programme formats which merely replicate existing commercial content, such objections arguably have some validity.“

The public broadcasters should provide for a distinction between public service obligations and the typical activities that any television broadcaster would carry out if it were to follow its own commercial interest of generating audience shares and selling advertising space. Otherwise, it will allow public broadcasters to define “public service remit” according to their own (commercial) interests.

A wide and all-embracing definition of the public service remit combined with State funding allows a Member State in effect to “reserve” a certain viewer share to the public broadcaster.

The situation is, however, particularly stark where the public service broadcaster is dual-financed by a combination of state resources and the sale of advertising space on the advertising market. The dual funding presents the unavoidable characteristic that the commercial activities also benefit from the state aid. Indeed, state aid to finance programme content results in a higher viewer share (*i.e.*, reach). Because reach is the determining factor for advertisement revenue, the increased viewer share leads to higher advertising revenues and market shares. Hence, state aid unavoidably distorts competition on the advertising market, in particular where the public broadcaster’s entire programming is considered a service of general economic interest. As a result, the private competitors and the public broadcaster no longer compete on a level playing field.

As a consequence we presume that commercial activities, such as the sale of advertising space, should not benefit, directly or indirectly, from a derogation from

EC State aid rules under Article 86(2) EC. This is supported by the Commission in the VRT Case, paras. 106 to 116.

By way of example of the impact on remit, we would draw to the Commission's attention some developments in the Austrian broadcasting market which have taken place since our March 2008 paper. A state aid enquiry is of course already under way. The Austrian pubcaster ORF1 is rightly seen as a mainly market-driven channel carrying much commercially attractive content (both Hollywood output and sports/football: ORF currently holds all key TV sports rights in Austria). Almost uniquely among mass audience generalist free to air channels, ORF1 has never fulfilled the quota foreseen by the AVMS Directive re European works. What is interesting is that ORF, like many of its counterparts, has launched cost-cutting programmes in response to its first-ever operational loss – but these savings are targeting the PSB's core remits. By contrast, only one sports genre is reportedly being considered for savings.

In too many European markets, the “full spectrum remit” apparently does not include the core PSB programmes, which are increasingly banished from the screens of PSBs to the benefit of programmes attractive to certain audiences (and, as case may be, to advertisers).

Another example can be found in the Spanish market where there are no significant differences between the public remit programming and the existing commercial programming. The definition of the PSB, included in a recently approved legislation (2006), is vague, imprecise and too broad, contributing to make programming oriented to increase audience figures rather than to serve public service remit. Additionally, the broadcasting of specific public service contents at key times (“peak time”) is much reduced (we calculate that only 17% of the contents during such time is strictly within the public service remit) This legal framework has resulted, for example, in the Spanish pubcaster RTVE being the main broadcaster of Hollywood films in Spain, programming such films usually at peak time. By contrast, most of the Spanish cinema films broadcast by RTVE were programmed very late at night.

This is not a problem which the European Commission can solve in isolation – but it is an interesting example of how supervision mechanisms need to be improved both at national and at European level.

### **6.1.2. Market Developments (para 51 ff)**

We would like to place on record our support for the Commission line at paras 53 and 54 on broadcasters and pay-TV, subject to a concern that a lack of detail may once again leave the Communication devoid of any real interpretative value.

We retain our view from our March paper that, in the unlikely event that publicly-funded broadcasters' activity on pay TV markets can be justified with reference to the universality/service of general interest logic which, we are repeatedly told, is the very *raison d'être* of state intervention in broadcasting, then this activity must be (a) at cost and (b) platform-neutral. Recent market developments, notably in Denmark but possibly also in other countries, show that this is not a purely theoretical debate.

An example of where imprecision in the draft Communication may lead to later uncertainty and litigation can be found at para 53 with reference to pay services “which are clearly non-commercial in their nature”. There are two problems with this qualification.

Legally, it appears to open up a new category of service – thus far, services offered by public broadcasters have either been “general interest” services (implying the obligation of universality) or commercial services. Now, the Communication appears to suggest that a third category of service, which is neither universal nor commercial, could be introduced.

Additionally, in practice this opens up a potential loophole which we believe some of our state-aided competitors and friendly Culture Ministries may exploit – maybe to allow a publicly-financed broadcaster to operate, on a pay basis, a so-called “minority sports” channel (which, as is often the case, would end up showing increasingly populist material) despite the fact that the taxpayer had already, via compulsory payment, paid for the content. If, on the other hand, by “broadcasting services with a pay element”, the Commission actually means a situation where a pubcaster may have to pay a fee for technical access then clearly there can be no objection beyond the requirement of platform neutrality as discussed in our earlier paper.

Finally, we do not see the relevance of relying, in a Communication on competition law, on a Council of Europe text (footnote 39). The ACT, as observers in the CoE drafting group which prepared this text, repeatedly sought to raise competition concerns about the draft text but we were informed that this was not possible as the CoE has no mandate for any consideration of competition matters. It therefore seems inappropriate to quote such a text in a competition law Communication.

### **6.1.3. Procedural Safeguards (paras 56 ff)**

While there is some helpful material in this section, again more detail is necessary if the Communication is to serve its purpose and reduce legal uncertainty.

Before commenting on the detail, we would like to express our great concern at suggestions made by certain MEPs and Member States that the “administrative burden” of *ex ante* regulation is somehow too onerous, particularly on smaller markets. This argument should be unambiguously rejected by the Commission, for the following reasons:

- Compliance with competition law necessarily involves a degree of administrative and legal expense on the part of market operators and regulators. This is a fact of life for businesses and we imagine that the European Commission, while making every effort to avoid unnecessary bureaucracy, would not be impressed by the argument that compliance with, for example, Articles 81 and 82 was too onerous for private sector business.
- Nor do smaller markets pose a problem here. By their nature, smaller media markets will usually be less complex to analyse and will contain fewer potential stakeholders, thereby allowing for shorter, simpler procedures.

Indeed, to illustrate this point, we understand that local variations of *ex ante* scrutiny are being introduced in Flanders and Ireland.

- Some form of so-called administrative burden is inherent in any compatibility assessment to be carried out, and in this case, it represents a reasonable compromise between the Commission's effort to entrust upon the Member States an important part of its duties as Guardian of the Treaty and responsibility for avoiding market distortions which are contrary to the common interests. This *ex ante* evaluation must clearly be regarded as a minimum condition for such an entrustment to take place, and a way to reduce potential complaints. This is also an opportunity for Member States to prove worthy of such a competence, which belongs to the Commission.

Turning to the detail of this section, Footnote 40 is particularly helpful in clarifying what matters should be taken into account in the Member States' assessment of new services proposed by a publicly-funded broadcaster. As such, we would suggest it be included in the body of the Communication rather than a footnote.

The draft Communication is also insufficiently clear when it comes to the independence of regulators. Para 62 speaks of an assessment which "would only seem to be effective" if carried out by an independent regulator (wording repeated at para 69 ref entrustment and supervision). This is unusually weak wording for DG Competition. The Belgian case makes some interesting observations on this point at para 230 and could usefully be referenced in para 62 of the Communication.

Our member companies' early experience in a number of markets shows some strengths and weaknesses of systems of *ex-ante* evaluation of public broadcasters' moves into new media. Independence is essential – otherwise it would be the pubcaster itself which decided, for example, whether a service was programme-related, or even whether it was a new service. Additionally, the assessment must be on an objective basis, rather than subjective notions of "public value".

Again, there are weaknesses and omissions in the current draft Communication. An example is the application of *ex ante* scrutiny to pilot projects. While it may be understandable that a full *ex ante* test may not be appropriate for every trial project, there is a very real danger that publicly-financed operators will argue that, once a successful trial has taken place, the service has already proved its value to the public and therefore can become a fully operational service without further – or, in practice, any – scrutiny. The final text of the Communication should make clear that, if Member States do choose to allow some latitude for pilot projects, there must be a clear obligation on the pubcaster to submit the operational launch of such projects for full and independent *ex ante* scrutiny.

We refer the Commission to our March 2008 position on the weaknesses of the BBC process, given the frequency with which the BBC Public Value Test is cited in this debate.

We are also concerned that structural deficiencies in the regulation of public broadcasters in one Member State may increasingly have an impact in other Member States. A current example is that it is widely expected that BBC Worldwide will

shortly launch channels focussing on Entertainment, Lifestyle, Knowledge, and an HD-channel in the Nordic markets and possibly beyond. BBC Worldwide is of course the commercial arm of the BBC. In theory, the BBC's internal Fair Trading Guidelines should prevent any advantage being given to BBC Worldwide that is not available to the BBC's competitors, including in terms of information and commercial advantage. But there are a number of outstanding issues surrounding the governance of Worldwide and the degree of separation between it and the publicly-funded BBC. Examples recently raised, among others, by independent producers giving evidence to the UK parliament<sup>4</sup> include:

- the fact that directors of the BBC and BBC Worldwide sit on one another's Boards;
- the fact that acquisitions by Worldwide are only referred to the BBC Trust if they are over £50m;
- Worldwide's guaranteed first-look at all BBC-produced content;
- The absence of a market mechanism which would disprove allegations that Worldwide was underpaying for BBC content.

The BBC Trust has already decided that they need to tighten both the mission and the guidelines around BBC Worldwide, and are currently undertaking their own enquiry<sup>5</sup>. Yet the fact that the internal controls in place between the BBC and Worldwide were not sufficiently rigorous may in this case impact not just on UK competitors to the BBC but also private sector operators in the Nordic territories (and, indeed potentially also the local public broadcasters) as these players have been denied the right to bid for attractive BBC content for use in their own services and will now have to compete with BBC channels which may have paid below market rates for that content.

Given the lead times necessary for any changes arising from the BBC Trust enquiry to filter through into practice, it may well be that the commercial damage has already been done by the time these issues are addressed.

We submit this as an example not just of the way in which public/private competition is constantly evolving but also as a further example of the need for pan-European minimum standards of independent regulation of state aid in broadcasting – such as are envisaged in the Communication.

One further issue relating to *ex ante* regulation is the argument put forward by pubcasters that the market impact assessment, because it took into account the impact on commercial operators of new pubcaster ventures, was tantamount to defining the pubcaster mission by reference to what was available on the market (i.e., market failure approach). The specific example has been raised of a news to mobile phones service: if there are established commercial services in the market, is a pubcaster thereby restricted from offering its news on a mobile TV platform (given that such a service would necessarily impact on the competing commercial service)?

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<sup>4</sup> House of Commons Select Committee on Media, Culture & Sport, 4 November 2008

<sup>5</sup> House of Commons Select Committee on Media, Culture & Sport, 18 November 2008

This argument is scaremongering from the public sector and should be rejected by the Commission on two grounds.

- First, public broadcasters who argue that the impact on commercial operators should not be taken into account are effectively arguing for the reinstatement of their monopoly status (or, at least, attempting to leverage their market power into new media, regardless of the budgetary and economic implications this may have for all other players –even including market foreclosure);
- Secondly, a specific response to the news on mobile TV example. Presumably a well-designed market impact analysis would not rule out a proposed service from a pubcaster on the grounds that it will have an impact on the market, but only if that service’s impact would be disproportionate. Given the centrality of provision of news to the debate about pluralism of the media, it is unrealistic to assume that any Member State would design an *ex ante* test which did not allow for the public value contribution to media pluralism of such a service to outweigh the negative market impact. This, surely, is the entire point of an *ex ante* test. Such an outcome would also appear to be entirely compatible with EU law, notably the News 24 decision.

## 6.2 Entrustment & Supervision (paras 65ff)

The Commission should be obliged to check that supervision actually takes place and works effectively. An issue we have identified in many European media markets was the lack of follow-through to deliver on agreed reforms. National politicians often regarded a decision in Brussels as meaning “case closed”, whereas in fact much of the detailed work still needed to be done. An emphasis on better control and supervision – as set out in Commissioner Kroes’ speech in Strasbourg in July 2008 – would be key. Could DG COMP in future set out some best practice criteria particularly as regards follow-up to be given to adverse findings at national level?

Para 70 could be rewritten as follows:

In the absence of sufficient and reliable indications that the public service is actually supplied as mandated, or in the presence of any indication to the contrary from reliable sources, the Commission would not be able to carry out its tasks under Article 86(2) and, therefore, could not grant any exemption under that provision.

- This means that, despite of having to limit itself to verifying that there is a mechanism for the monitoring by an independent body of compliance by the broadcaster with its public service remit, the Commission can request the Member States to submit evidence that such mechanism was actually used, whilst not replacing the Member State in the specific assessment of compliance with the qualitative criteria.

The Commission is obliged to undertake a diligent and impartial investigation of the evidence put forward by the Member State.

There is also a need for national regulation to be not just independent, but also systematic. Reports by NRAs, NCAs and Courts of Auditors must be at regular

intervals and the implementation of their findings must be closely monitored. Too many European pubcasters have yet to fully accept the fundamental changes in the media landscape, even those such as the move to a dual broadcasting system which occurred around 25 years ago. As such, the organisational culture in many public broadcasters is to object vociferously to any intervention from a regulator or competition authority.

### **6.3 Funding of Pubcasting and the Proportionality Test (paras 71 ff) (including Transparency Requirements for the State Aid Assessment)**

Paras 71 to 76 are in our view uncontroversial. Issues in our sector arise mainly due to the unwillingness to apportion costs between public and commercial activities, which may produce different results in different markets, depending on the degree of access the pubcaster has to the advertising market and the degree of dominance it has in that market. We have set out our views at some length – not necessarily because we expect them to be incorporated into the current draft Communication, but rather to show that there are a number of alternative solutions which may be appropriate, depending on the characteristics of the broadcasting market in question.

The main example for the situation described in paragraph 77 would be the cost of acquiring or producing programmes in the framework of the public service mission of the dual-financed broadcaster. These programmes serve both to fulfil the public service remit and to generate audience for selling advertising space. However, it is virtually impossible to quantify with a sufficient degree of precision how much of the programme viewing fulfils the public service remit and how much generates advertising revenue. For this reason, the distribution of the cost of programming between the two activities risks being arbitrary and meaningless, unless they are closely connected to some form of quantitative evaluation of the level of fulfilment of the public service remit. This evaluation should be carried out annually by the Member States through an independent entity, and used to assess proportionality of public compensation. Therefore, Member States should reduce the possibility of distortion, by implementing some form of quantitative evaluation of the level of fulfilment of the public service remit, and then applying this ratio to public service costs in order to determine the net cost of public service and thus avoid cross-subsidisation and cost overcharging.

This implies ex ante quantification of public service obligations, which seems to be the only way to provide certainty to all market players when assessing proportionality. There are precedents, both academic and in practice. DG Competition may wish to study the work of Professor Robert Picard<sup>6</sup> who has focused on the analysis of public service broadcaster's management performance, «once public service broadcasters are large, well-funded organisations that need oversight to ensure effective internal use of resources».<sup>7</sup>

A possible example of good practice, although still too recent to allow for full implementation and evaluation, is the current Public Service Contract for the Portuguese public broadcaster, RTP, which clearly demands, among other

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<sup>6</sup> [www.robertpicard.net](http://www.robertpicard.net)

<sup>7</sup> "Assessment of Public Service Broadcasting: Economic and Managerial Criteria," Javnost/The Public, 10(3):29-44 (2003).

requirements, that the undertaking demonstrates its cost per broadcasting hour. There is also a rule saying that current investments may not exceed cash flow generated by amortisation and divestments in each 4 year term.

The Portuguese system is also closely monitored - a report on public service must be presented to Parliament, accompanied by an opinion of internal audit as well as an Assessment Board composed of several representatives of society and covering in detail, the index and criteria used to evaluate accuracy, management, proportionality and transparency in relation to public service obligations<sup>8</sup>.

Alternatively, an Opinion of the State Aid Experts Group expresses some interesting and pertinent views on this issue: re the suggestion of an ex post analysis of costs and profits (this idea could be taken up as a recommendation for regulators/auditors in view of overcompensation)<sup>9</sup>.

Looking beyond Europe, there are numerous proposals of measuring quality in broadcasting, such as the Study which NZ On Air commissioned in 2006, which details and compares measures used in a variety of OECD countries, demonstrating that it is possible to measure quality requirements, hence allowing some quantification of public service mission fulfilment.

#### Cost Allocation and EU law

We are particularly concerned that Paragraph 84, according to which the «specificities» of the public broadcasting sector allow all the costs to be classified as public costs – has the effect of frustrating the Commission in its tasks.

Further, we would like to point out that proper cost allocation is intrinsically linked to a clear and detailed definition of the public service remit which cannot be left to the broadcaster itself in order to enable ex-post control.

This constitutes a derogation from the case-law of the European Court of Justice in the field of State aid (see in particular Joined Cases -83/01 P, C-93/01 P and C-94/01 P, *Chronopost v Ufex and Others*, para. 40; see also para. 16 of the Community Framework for State aid in the form of public service compensation, OJ 2005 L 312, p. 67). This case-law is based on the fundamental assumption that costs which are common to public service activities and non-public service activities ("common costs") must be allocated on an "appropriate" basis between the two. This principle was first developed by the European Commission and later confirmed by Court of Justice in the field of State aid - as opposed to the field of antitrust where no equivalent principle exists. The purpose of such test is precisely to prevent State aid

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<sup>8</sup> There is also a provision stating that the Ministry of Finances and the Audiovisual Ministry shall monitor the implementation of the Contract, the former, namely through the Inspectorate General of Finances, which must conclude a Protocol subject to both Ministries, in order to identify the necessary disclosure obligations and data. Finally, there is a provision for an External Audit on the level of public service, which must be carried out by an audit appointed by the national regulator, and shall include the verification of effective fulfilment of public service obligations, transparency and proportionality of financial flows, as well as conformity with best practices, namely in terms of acquisition of production raw materials and labour force, as well as in the formation of commercial prices. This Audit shall always end up by the issuing of a Recommendation

<sup>9</sup> See also work carried out by Professor Nuñez Ladévez for the Spanish broadcasting association UTECA, available at [www.uteca.com](http://www.uteca.com)

being granted, for the purpose of a public service mission, to purchase certain assets which ultimately are exploited commercially by the public service operator without proper remuneration being paid in return (the problem of cross-subsidisation). Whenever State financed assets are used for commercial purposes without a proper remuneration being paid by the operator, competition is distorted in relation to those undertakings that do not have free access to similar assets. This is precisely the problem in the area of public service broadcasting where commercial broadcasters are obliged to compete with pubcasters which have been offered their entire infrastructure (including equipment, fixed installations, personnel, etc.) by the State in order to carry out a public service mission.

The ACT agrees with the Commission that, in the particular field identified at para. 85 of the draft Communication, it may be difficult to carry out a proper cost allocation in relation to the production of programmes which serve both to fulfil the public service remit and to generate audience for selling advertising space. For this reason, we accept that the appropriate test in this particular field might be of a different nature and should primarily test whether the pubcaster maximises his profit in the advertising market. We revert to this point below.

However, in no other areas do we see any compelling reasons for the Commission to derogate from the general State aid principles set out in the Chronopost judgment and highlighted in the 2005 Framework on Public Service Compensation.

In particular, we are concerned that §§ 82 - 85 in their present wording imply that all types of common costs in the area of public service broadcasting are of a special nature and may for that reason be entirely allocated to the public service mission.

As an example, a pubcaster which runs several channels (e.g. one public service channel and several non-public service channels) might incur expenses to e.g. the acquisition of programmes, personnel, equipment and buildings, which ultimately are used for both channels. The same programmes could be broadcast on both channels; the same (both operational and administrative) personnel could be used to support both channels; the same equipment could be used for the purpose of both channels; the same buildings could provide shelter for both channels, etc. In such a situation, it would seem that the Commission would allow the broadcaster to define all common costs as public service costs related to the public channel, which in turn could be financed by the Member State as "genuine" public service costs. At the same time, the pubcaster's commercial channel would only have to cover the remaining costs, which could for that reason be very low.

The ACT does not agree that such an approach is compatible with the State aid rules of the EC Treaty as defined by the European Court of Justice. It invites the pubcasters to speculate into ways of circumventing the normal rules of cost allocation by artificially increasing their public service costs while artificially lowering their commercial costs.

The ACT therefore suggests that paras. 82-85 of the draft Communication be reformulated to address the above concern. In particular, the Commission should stress that the standard Chronopost-test under Article 87 applies also in relation to public broadcasting and that this area is, as a clear point of departure, no different from all

other utilities sectors. We recall that in other utilities sectors, e.g. transport and postal services, public service operators must allocate their common costs (relating to e.g. equipment, vehicles, buildings, staff, etc.) "appropriately". Reference is made e.g. to the cost allocation formula set out in Article 14 of the Postal Directive (see Directive 97/67/EC as amended by Directive 2008/06/EC, OJ 2008 L 52/3). The real problems are (a) according to which criteria should one allocate costs to the public service activities if the public service remit is vague and (b) absent independent external scrutiny, there may be a lack of incentive on the staff of the pubcaster to comply with the rules.

If the Commission finds that the costs of advertising, in a dual-financed system, constitute such a specific situation that an exception to the Chronopost-regime is warranted and compatible with Article 87, then we suggest that a particular regime for the advertising costs be described as an exceptional situation which must be interpreted strictly since it derogates from the general prohibition under Article 87 EC.

One suggestion, which we recognise is not without difficulties, is to look not only at real advertising income, but also at potential income. This minimises the negative impact that the absence of proportional cost-allocation has, allowing the Commission and the national supervision authorities to overcome the difficulties to obtain a correct determination of the net cost of public service, and, potentially, could be a remedy against price undercutting<sup>10</sup> in the advertising markets. We should stress that this test is not a "one size fits all solution" and is not suitable for all European markets, given that the public broadcasters' intervention on the advertising market can range from zero to dominance, with a number of variations in between (either limited airtime, or no distinction in minutage between the public and commercial sectors).

The core of the issue here is that dual-financed pubcasters compete against commercial broadcasters for attractive programming in the knowledge that, no matter what the costs of that programming are, there will always be public funding to pay for it, so the advertising return which that programming is able to generate becomes a secondary or irrelevant factor. Nor does the public broadcaster have to worry about the correct commercial price for that programming.

A standard proportionality assessment does not take us much further, so long as all «common input costs» may be entirely attributable to public service activities (because they correspond to the public service remit). With the current trend to enlarge already vague public service remits, and the legal impossibility of questioning this other than by proving manifest error, it has become progressively more difficult to identify costs which do not fall under the remit.

Hence our suggestion that, instead of the real advertising income that is to be generated by the pubcaster, regulators could look at the potential advertising income which could be generated by the pubcaster, assuming that it corresponds to its viewing share.

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<sup>10</sup> A good example of price undercutting can be found in the Spanish market. In 2007, the Spanish PSB decreased its advertising price, although the advertising turnover increased as the advertising time occupation also went up.

Applying the percentage of viewing share delivered by the pubcaster's programming services to the value of the television advertising market, the regulator could then obtain the correct figure which corresponds to the pubcaster's commercial potential, on an ex post analysis.

The test would, then, compare the value obtained as indicated, as potential income, with the full costs reported, regardless of their nature, and then determine the balance. The difference towards real advertising income, if any, would show a deviation due to a more commercially oriented profile, not supported by advertising (and so far, illegitimately supported by public funding). It may also be the result of a legal or administrative limitation, but in this case the cost structure should be adjusted to this.

For the next step, there would be an *ex ante* established threshold, setting up the maximum level for public funding of common costs, to prevent such a difference from being supported by the State, according to the following procedure:

In theory, each broadcaster has a natural share, which is given by the result of the splitting of the total television expenditure by the number of FTA broadcasters. Then, in practice, it is for the free float of market forces to determine the correct allocation, as a consequence of viewing share and commercial performance.<sup>11</sup>

Arguably, should the public broadcaster be allowed to sell advertising, thus participating in the definition of the global television expenditure, it would have an incentive to avoid undercutting advertising prices, because this could induce a lower natural share, and therefore it would end up reducing its global funding level.

Let us recall that the main purpose of this revised test is to avoid the consequences of a public broadcaster's aggressive policy in terms of programming acquisitions, especially when part of its costs are publicly funded, but without going as far as saying that those acquisitions can only be supported by commercial funding, an idea which would be impossible to implement.

So, the suggested wording to be added to the §84 would be something along the following lines:

«In order to prevent possible distortion induced by undesirable compensation of competitive inefficiencies by public funding, the benefits of commercial activities to be taken into account when determining the net cost of public service must reflect the full market potential of the public service broadcaster programming, measured by its viewing share.»

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<sup>11</sup> Market dimension is given by the amount of global television advertising expenditure. This means that, when structuring the television market, each Member State normally considers how many broadcasters the advertising market is capable of supporting.

Setting the public broadcaster aside when considering the market dimension is tantamount as to accepting that it does not have to behave as any other market player, thus allowing it to compete for programming acquisition, for viewing share and even for advertising, whereas all the competitors do have to worry about market value of their programming acquisitions. So a public broadcaster should be counted as a full market player when considering market structure— even in case it doesn't compete for advertising, because it competes for viewing share.

«Therefore, the net cost of public service, which may be offset by public funding, should be the result of equivalent to the balance between all pubcasters' exploitation costs which are attributable to public service, on the cost side, and the income which the public broadcaster would obtain in the advertising market, in consideration of its viewing share - however, the public compensation may never exceed the result of splitting the global television advertising expenditure by the number of free to air broadcasters competing in that same market», evaluated on a yearly basis.»

This would place the public broadcasters on a level playing field with commercial broadcasters when aiming at the same programmes, because, even if they do not have to cater for advertising income to cover costs, they would, at least, have to adjust their spending level and their programming policy to their profile as pubcasters.

Otherwise, the Communication can be read as allowing pubcasters to acquire programming which competes against commercial broadcasters regardless of cost, given the fact that it would either be supported by advertising or by public funding – the very basis of the unacceptable market distortions of the dual-financed system.

#### Separation of Accounts

The requirements of the Transparency Directive are naturally aimed at enhancing the European Commission's capabilities in the area of illegal State Aid by introducing a reporting regime for both public and private undertakings in receipt of public funds. Firstly the regime seeks to ensure that the accounts of public undertakings are sufficiently transparent to expose the funding they receive from public authorities, that is not easily identifiable as state aid and which may consequently escape the state aid rules; Secondly to ensure that the accounts of undertakings (whether private or public) are sufficiently transparent to help identify the cross-subsidisation of their other activities by public funds, where the level of compensation to undertakings for the delivery of public service obligations is excessive.

In the case of a SGEI, the purpose of the Directive is to identify the costs and revenues attributable to the SGEI's special or exclusive right from all and any other activities which the undertaking carries out (whatever their nature) so that (not least) the competitors can know how much public compensation it is receiving for the functions it carries out.

Some public broadcasters may currently lack the skills and resources, or the will, to split accounts and allocate costs between public and commercial services. However the presence of good practices among some public broadcasters shows that this is both possible and reasonable for all pubcasters to comply with these transparency requirements: for example the Finnish YLE 2007 Report<sup>12</sup>, which, on page 7, displays a cost distribution according to the different programming genres.

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<sup>12</sup> [www.yle.fi](http://www.yle.fi)

To reaffirm the importance of full transparency, we suggest that para 86 could be strengthened as follows (additional text in bold):

“The separation of accounts as outlined above is essential to ensure transparency and enable fair and effective control of public financing. The Commission considers that such transparency can be further enhanced by an adequate separation between public service and non-public service activities at the level of the organisation of the public service broadcaster. Functional or structural separation normally makes it easier to avoid cross-subsidisation of commercial activities from the outset and to ensure transfer pricing and the respect of the arm’s length principle, and is normally the only way to provide full transparency for external supervision. Therefore, the Commission invites Member States to consider functional or structural separation of significant and severable commercial activities, **and strongly encourages** it as a form of best practice. **This applies to all forms of raising commercial income in relation to programming such as advertising, soft sponsoring, merchandising, phonograms, books and video selling, etc.**”

Additionally, after para.87, a reference could usefully be made to some paragraphs on Market Conform Behaviour from the Irish Decision<sup>13</sup>

...as well as any arrangement in respect of third party access to the archives of public service broadcasters. Member States must implement the following mechanisms to ensure arms’ length principles in respect of transactions as between public service objects and the exploitation of commercial opportunities:

- Enunciation of an object for public service broadcasters to exploit such commercial opportunities as may arise during the course of the public service broadcaster’s fulfilment of its public service objects;
- Statutory requirement for transactions and arrangements entered into by public service broadcasters between, on the one hand the public service objects, and on the other hand, the pursuit of the object to exploit such commercial opportunities (as may arise during the course of the public service broadcaster’s fulfilment of its public service objects) to be made at arms’ length.
- Require public service broadcasters to report, on an annual basis, on the use they have made of the public funding they have received, and to distinguish between transactions and arrangements entered into in pursuit of public service objects and the pursuit of the object to exploit such commercial opportunities as may arise during the course of the public service broadcaster’s fulfilment of its public service objectives.
- Commercial transactions shall be operated in an efficient manner so as to maximise revenues, and that any profits arising from such commercial activities shall be utilised to subsidise public service broadcasting activities

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<sup>13</sup> According to § 162 of Case E 4/2005 (Ireland)

### **6.3.3.2 Overcompensation (paras 89 ff)**

We consider that any overcompensation of public service costs, in principle, must be strictly regulated to be recovered at the end of the financial year.

Having regard to the Community Framework for State aid (2005/C 297/04), as well as, the Commission Decision of November 2005 on application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation (2005/842/EC), the revised Broadcasting Communication should specifically cap the amount of overcompensation that public service broadcasters may carry forward to the next financial year.

In case of repeated surpluses, Member States should be required to re-evaluate the public service broadcaster's actual financial needs. In such a situation the concept of strict analysis of the adequate costs, the connected revenue earned from public service and reasonable profit, as stated in the community Framework, mentioned above, should be properly taken into account.

Also, effective control mechanisms must ensure that such carry-forward overcompensation is used exclusively for public service purposes in the next financial period so as to prevent cross-subsidization.

It is important to ensure should in addition that the controlling entity be independent from political influence and its (in)actions should be subject to effective judicial review. The controlling entity should have the appropriate means to ensure compliance by the public service broadcasters with its findings.

The effective means put in place for monitoring the performance of the budget, described in the following paragraph, must also make sure that allowing 10% of budgeted expenses to be carried forward to the next financial period does not have the undesirable effect of inviting public service broadcasters to create additional projects simply to absorb the surplus. This means of course that there must be management control mechanisms to closely monitor the rising of programming costs, in order to avoid inefficiency.

### **6.3.3.3 Control Mechanisms**

- In assessing the effects of State Aid in the broadcasting and also on the new audiovisual media markets, the supervisory bodies as well as the Commission must always consider that there is already an unquantifiable competitive advantage on the fact of having stability and high predictability in terms of revenues whereas broadcasters who are economically dependent on subscription and advertising markets are usually only able to predict their revenues within a three to six month horizon.
- Periodic evaluations should be carried out by professional independent audits, with proper cost allocation made according to consistently applied, objectively justifiable and clearly established cost-accounting principles and the results should be published, in order to obtain public accountability.

- In any case of overcompensation there must be a swift and effective mechanism for the reimbursement of the amounts exceeding the financial needs of the public service broadcaster.

#### **6.3.3.4 Market Distortions (para 101 ff)**

We would like to suggest a further “abuse” in para 102 following a recent development in the Portuguese market:

“or if they abused any public service broadcaster privileges by spreading the events through various programming services, in order to demonstrate the unavailability of such rights for sublicensing purposes.”

We also restate our March submission on these points:

If public broadcasters were to use their public compensation to structurally overbid private competitors by consistently and regularly offering prices which are significantly higher than what private operators would be able to pay and thus empty the market for premium rights, such conduct could lead to the crowding out of private competitors, which could affect trading conditions and competition contrary to the common interest, without being necessary for the fulfilment of the public service. In order to avoid such anti-competitive behaviour, the Commission invites Member States to enhance transparency concerning the general framework governing the acquisition, use and possible sub-licensing of premium rights by public broadcasters.

- The proportionality test requires balancing the needs of public broadcasters as regards the fulfilment of their public service against the adverse effects on competition
- Sports programming can be part of public service remit but must be limited to what is necessary for the fulfilment of the properly entrusted public service remit – this implies that the financial needs of the public broadcaster are not artificially increased by not offering third parties sub-licenses for unused rights and clear rules on sublicensing rights.
- State financing used for exclusive rights which the public broadcaster cannot or does not intend to use would not, in principle, be justified under Article 86 (2) of the EC Treaty.
- This requires that the public broadcaster’s behaviour as regards the acquisition, use and possible sub-licensing to third parties is made transparent and predictable for third parties. In this respect, it is important to clarify when a right is regarded as not used as well as the circumstances and conditions, under which public service broadcasters would offer such rights to other operators<sup>14</sup>

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<sup>14</sup> See Case E -3/2005 (Germany) paragraph 295 to 301

Our final comments are procedural. Member States should prevent competent jurisdiction from denying material justice on the cases presented before it, on the basis of formal or simple procedural arguments or formal omissions.

Finally, the matter of third party rights under para 106 is obviously crucial to private sector stakeholders . It is of course essential, and a basic requirement of natural justice, that interested parties should be allowed the right to argue their case before an independent body. This is a vital procedural point without which the Communication's efforts to ensure a balanced, competitive media market will fail. In the absence of such safeguards at national level, the private sector will have little alternative but to bring cases to the attention of the European Commission, rather than seeking to resolve them at national level.

**Association of Commercial Television  
January 2009**