

ETNO Reflection Document on the draft “Community Guidelines for the application of State aid rules to rapid deployment of broadband networks”



June 2009

Introduction

ETNO welcomes the opportunity to express its views on the draft “Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks.”

Below are some general considerations, followed by specific comments and concerns, on the draft Guidelines.

Fixed and mobile broadband networks and services have experienced a rapid development in recent years throughout the European Union (EU), with growing penetration rates and the emergence of new and advanced on-line services. This development has been made possible thanks to huge investments done by market players, to upgrade their network to allow for the provision of a first generation of broadband services to customers.

However, the future of the telecommunication industry depends on the development of next generation networks (NGNs) – both access and core, which will create a new broadband scenario allowing for advanced services to the benefit of the whole of the European economy. NGNs deployment is also crucial for the EU to keep and enhance its competitiveness in the world.

The deployment of high speed NGNs – and especially next generation access networks (NGA) -- requires large scale investments¹. ETNO is convinced that investments to bring NGA to EU citizens must be primarily carried out by private capital, as has been case for the first generation of broadband services.

Against this background, ETNO believes that, in order to pursue the objective of a sound and large scale deployment of new NGN, the European Commission should in the first place create the right

¹ the costs of rolling out a European wide NGA networks have been estimated to be at around 250-300 billions € (McKinseyAnalysis)

regulatory conditions to foster private investments, that is, to allow operators to receive a reasonable return on their investments. The Commission should orient regulatory policies toward the objective of broadening the investment case for private investment, including forms of risk sharing amongst operators, by all market participants. Such an objective for the EU has been highlighted by the European Council of March 15th.² In fact, member states' intervention in the financing of NGA development projects will be less necessary in the presence of a sector policy conducive to increasing and long term investments by the private sector.

ETNO believes that public intervention aimed at the deployment of new fibre broadband network, though useful in some cases in rural / underserved areas, must never be detrimental to investments by market players. Any form of public intervention foreseen for NGA must satisfy the primary and fundamental condition of not hampering private investments in a specific area or region.

Moreover, as stated, ETNO believes that investments by telecommunications operators are the best way to ensure an efficient development of NGA in member states. Against this background, in cases where public intervention is granted for the development of NGA, it must never jeopardize efficient allocation of investments within the internal market. In other words, funding by the State or local authorities should never allow for a mere duplication of infrastructures, nor should it be granted in a non-symmetric way to some market players to the detriment of market well functioning.

In the first instance an appropriate, more investment friendly regulatory environment should be ensured by the regulator. State Aid cannot be a remedy for a problem which root cause could be changed by the right application of the regulatory framework. Secondly, Member States should consider the adoption of measures accelerating the investment cycle and, only as a measure of last resort, direct state interventions can be applied in cases where there remains to be no viable business case for at least one private investor. As the cost of civil works required to build NGA networks represents a large part of total investments, access to civil works should be fostered to lower the costs of network roll-out, and increase the likelihood of private

² European Council Conclusions of March 15, 2009: In line with the conclusions of its December 2008 meeting the European Council recalled the fundamental role of telecommunications and broadband development in terms of European investment, job creation and overall economic recovery. Taking account of the risks taken by the investing undertakings, efficient investment and innovation in new and enhanced infrastructure should be promoted. To this end, various cooperative arrangements between investors and access seeking parties to diversify the risk of investment should be permitted, whilst ensuring that the competitive structure of the whole market and the principle of non discrimination are maintained. In this context, it invites the Commission to develop a European broadband strategy, by the end of 2009, in close cooperation with stakeholders.

investment, e.g. by making available access to ducts of all utilities and not just of the incumbent operator. Moreover, ETNO believes that another cost-effective and competitive neutral way of public funding are public subsidies aimed to modernize in-building wiring. Depending on the architecture of the network (e.g. FTTH) fibre in-buildings wiring can amount up to 50% of the total cost per home connected. Public intervention in this part of the access network in white NGANs areas would have less distortive effects than in any other part of the network and should be explored first as it could also result in a positive business case for one or more private NGANs.

Measures facilitating investments should not only include easing of administrative and other technical burdens (point 55-59). Measures leading to lower capital costs of investments such as tax incentives should also be taken into consideration.

As a general remark over the possible use of public funding - in specific areas - to finance the development on NGNs, ETNO maintains the following:

- There are areas with a challenging return on investment (RoI) in the business case or even below the threshold for a commercially viable investment, i.e., areas where the expected average revenue per user (ARPU) and user density equation leads to less than one commercially viable network. For reasons of e-inclusion and of rural development, i.e., to avoid a digital divide that would disadvantage citizens in such remote or rural areas, public or private/ public subsidies could be judged appropriate. Such subsidies should, however, be strictly limited to areas where no private network has been rolled out yet or will be rolled out in the future ("white areas") and be structured in such a way that they complement, instead of compete, with market driven activities and shall encourage the evolution of different technologies.
- Great care should be taken in the rules for the availability of public funds to prevent the crowding out of private investment by public money and ensure that the most efficient and cost effective solution for bridging the digital divide will be applied. This also implies that the investor with the best economic offer will be selected. It would be arbitrary to exclude or disadvantage investors because of their past or future investments in broadband networks or their market position.
- The public sector can play a very important role in boosting the demand for broadband infrastructure by promoting services such as e-government and e-health, completing the digitalization of the relationship between EU citizens on the one hand and public administrations and its services on the other. This could be made possible also through member states promoting the use of broadband infrastructure, for example, by:
 - Usage of the electronic 'highways,' rather than physical transport, e.g. through tax incentives

- Secure e-commerce, reducing the demands for space and energy of the logistics sector, e.g. through demanding security certification of such infrastructures and business applications.

The role of demand-side initiatives is also very important and should therefore be considered by the Commission as a criterion in assessing the validity of financing for NGA. Sustaining the demand for and take up of advanced broadband services offered over NGA can have positive effects on operators' choice to invest in high speed networks.

On the specific points in the draft Guidelines, ETNO has the following comments and concerns:

1. Definition of NGN (point 48 of the draft Guidelines)

As the Commission is aware, a variety of players are involved in high-speed broadband roll-out strategies. For example, there are incumbents investing in FTTC/N and FTTH/B, cable operators upgrading to DOCSIS 3.0, satellite operators increasing capacity and installing two-way systems for multi-services delivery, wireless operators deploying WIMAX, mobile operators upgrading to UMTS or LTE and public and/or public-private local initiatives investing in FTTH/B. At present, there is a fluid situation in broadband markets with considerable substitution between specific services – temporal and otherwise.

Accordingly, the Commission's working definition of NGA, i.e.,

1. "laying fibre to existing street cabinets offering the prospects of downstream bandwidths of a minimum of 40 Mbps and 15 Mbps upstream (compared with today's downstream speeds of a maximum of 8 and 24 Mbps for ADSL and ADSL2+ access technologies, respectively);
2. upgrading current cable networks to deliver speeds up to and beyond 50 Mbps against the previous maximum speed of 20 Mbps, using the new 'DOCSIS 3.0' cable modem standard, or
3. connecting newly built homes and offices with fibre connections offering services up to 100 Mbps and beyond,"

appears limiting as regards both bandwidth and access technologies. For example, such a definition does not recognise that VDSL permits new and improved services as compared to current generation broadband and are regularly considered as 'NGA' networks.³ This

³ European Commission, Draft "Commission Recommendation on the regulated access to Next Generation Access Networks (NGA)," (12 June 2009).

should be recognised by the guidelines. No particular technology, such as wireless, mobile and satellite, should be explicitly excluded from consideration.

2. The distinction between white, grey and black areas for NGA networks and the compatibility assessment (chapter 3.3 and 3.4 of the Guidelines)

ETNO agrees with the Commission that it has been valuable to develop an analytical schema to distinguish between the types of areas, depending on the level of broadband connectivity available, to be targeted by state intervention. This was achieved with the 'white,' 'grey' and 'black' area approach.

Different from current generation broadband where deployment has to a large extent already taken place, many NGA investments are at a nascent stage and the business case for private investors is uncertain due to changing market conditions and the considerable risks involved. The risk of 'crowding out' such investment by state-financed networks therefore is even greater than for current generation broadband. The trade-off between the advantages, in terms of local economic development and support to the 'Information Society' and 'e-Inclusion,' and the disadvantages, in terms of distortion of competition and possible disincentives to private investment, has to be thoroughly assessed. The foreseen advantages of state aid – whether made by national, regional or local authorities -- should be well documented and subject to a detailed analysis to ensure that the least distorting funding is adopted.

ETNO believes that the fundamental aim of the Guidelines should be to create the highest degree of legal certainty possible for private investors with regard to the future application of State aid rules for broadband. The Guidelines should therefore give clear indications on the future application of State aid rules in "white", "black" and "grey" areas, which go beyond a reference to general concepts such as the balancing test.

The following principles should be kept into consideration when assessing the potential benefit of public intervention to NGN:

- Frontiers between black, grey and white are highly hypothetical and moreover could be distorted by inappropriate intervention. Hence, the priorities to minimise potential problems resulting from the existence of non black areas, and therefore the volume of intervention, is first to favour the maximum natural geographical extension of black areas and second to favour the maximum natural extension of grey areas outside black areas.

- Legal and regulatory environment that is favourable to private NGA roll-out should be the first objective of policies in order to have maximum expansion of areas where network roll-out is driven by market forces (black and grey areas);
- A very clear and precise definition of the market failure which is deemed to be addressed by public intervention must be identified. More specifically:
 - In case of a problem of coordination and/or anticipation for market take-up, then the correct public intervention mechanism should be – as anticipated - to encourage the demand for next generation services;
 - In case of coverage problems concerning rural or remote areas, a public intervention could consist in an investment in passive fibre terminating segment, which will complement the private investment in fibre access network, eliminating the cost discrepancy between rural areas and profitable areas and allowing private operators to connect their fibre networks to this publicly funded terminating segments and open their services on competitive grounds to the public. Such intervention should be concentrated today on white areas.
 - if, in spite of the subsidised terminating segments mentioned above, some areas still appear to suffer from excessive delay between service widespread diffusion in the population and service provision by at least one private investor in the concerned areas, then public intervention may be useful to contribute to subsidise the fibre access network itself in order to make sure that service will be provided. But this should be subject to a criterion of a significant difference in timing between the time when the use of specific fibre service have become widespread within the population and the timing when it becomes available to the concerned areas.

As a further remark, ETNO would like to underline that the Guidelines should specify that Member States, when identifying geographic areas qualifying for public funding, must ensure that an open and transparent Public Consultation is conducted with the aim of consulting all stakeholders possibly affected by the proposed measure in such areas. Only in case that no operator shows an interest to invest in the corresponding geographic area, the local or regional authorities would be allowed to tender for the construction and management of a publicly owned Broadband infrastructure.

White areas

ETNO maintains that “areas where no [traditional or NGA] broadband infrastructure currently exists” -- and no NGA

infrastructure will be deployed in the foreseeable future - should be considered 'white NGA' areas for the purposes of state aid analyses.

However, in its Draft Guidelines, the Commission argues that the existence of 'traditional' broadband networks should not be taken into account when defining 'white NGA' areas in applying state aid rules (footnote 50). ETNO believes that such a wide definition of 'white NGA' areas proposed could unduly extend the scope of state aid. It risks, for example, discouraging investment in xDSL and mobile broadband outside urban zones, as a private investor could fear its investment be devalued by a publicly-financed NGA investment.

The definition of a 'white NGA' area should be better specified, in that it is not entirely clear when an area could be considered as 'white' from a new infrastructure perspective.

If on the one hand, areas where no broadband infrastructure at all exists may justify public intervention, on the other - as the Commission itself specifies - the existence of an advanced basic broadband infrastructure capable of offering services (ADSL 2+) similar or very near to services provided by an NGN infrastructure, may nonetheless require an upgrade to NGA. In order to avoid inefficient allocation of public funding, the Commission should better specify that in case of existing broadband infrastructure or upgrading in the near future the Guidelines should provide for specific safeguards to avoid a devaluation of these investments. As a minimum requirement, network operators that have invested in traditional broadband networks in the past, must be able to fully take advantage of their investments when applying for a subsidized NGA project in the future. Such rules should be included in **para. 45e** and **para. 74** of the draft Guidelines.

- ***The analysis of "needs of citizens and business users" (point 68)***

According to the proposed treatment of 'white NGA' areas, the grant of state aid for NGA in areas where current generation broadband networks exist is to be subject to demonstration by the member state concerned that "the broadband services provided over the said networks are not sufficient to satisfy the needs of citizens and business users in the area in question (also taking into account their eventually planned upgrade)."

ETNO welcomes supplementary criteria for the granting of state aid for NGAs in areas where a privately built broadband infrastructure exists. The proposed approach could, however, introduce considerable subjectivity into the assessment of state aid measures. The "needs of citizens and business users" are very difficult to identify and assess – even for commercial players operating in the market. Such needs may rely on a series of aspects, like social, economical and cultural factors, which vary from country to country. It appears difficult to

demonstrate in advance that needs are not being sufficiently satisfied by current generation broadband networks and planned network updates, which will make available new features and services to the citizens and business users in a given area.

The “*needs of citizens and business users*” may not be met if the use of NGA specific services have become widespread within citizens and businesses, but are not provided, or are not planned to be provided, in the considered area.

Such considerations are also worth in the case of grey areas (see below)

- ***The analysis of ex ante regulation (point 68)***

According to the draft Guidelines, the granting of state aid for NGA networks in ‘white NGA’ areas is to be subject to demonstration by the member state concerned that “there are no less distortive means (including ex ante regulation) to reach the stated goals.” ETNO welcomes this condition which corresponds to the requirement of proportionality. However, it should be clarified in the draft how *ex ante* regulation could contribute to achieving the goals pursued by state aid in a given area where no NGA is deployed yet. We therefore suggest to specify in pt. 68 that

*“[...] there should be no less distortive means (including **adapting** ex-ante regulation to **provide better incentives for investment in new and enhanced access networks**) to reach the stated goals.” .*

Grey areas

As regards ‘grey NGA’ areas, the Commission rightly acknowledges that “State intervention in such areas risks crowding out existing investors and distorting competition”. In the assessment of ‘grey NGA’ areas, where “one private investor has already deployed a NGA network or may be in the process of deploying it in the next [5] years and there are no plans by any private investor to deploy a second NGA network in the coming [5] years”, the Commission should very carefully consider the risks associated with the duplication of an existing - or likely to exist in the near future - NGA infrastructure. In particular, the Commission should carefully assess that public intervention is not used as a mean to remedy competition concern in a specific area. In other words, state aid should not be used to address a market concern (from a regulatory point of view), above all in case

competent regulatory authorities have already defined remedies in regulated wholesale broadband markets.

As in grey areas a viable business case by definition only exists for one single network, state subsidies for the duplication of a network will automatically result in economic inefficiencies and will render both networks immediately unprofitable. Furthermore, such duplication would always distort competition, as private investors can never compete with a state funded network. In consequence,, the prospect of potential competition by a subsidised infrastructure will prevent any reasonable private investor from investing.

A key feature of the assessment of state aid for NGA is the fact that it cannot be based on an observation of the actual deployment of networks and the resulting provision of services, as investments still have to take place and NGA based services will further develop. To illustrate, for DSL-based broadband, at the time first DSL-lines were deployed it was not certain that ADSL2+ download speeds of up to 24 MB/s would be possible on the copper network.

This makes any assessment of whether NGA networks deployed by private operators will be sufficient in the future to satisfy the needs of citizens and businesses highly speculative. The risk of crowding out such investment or inefficiently duplicating it by state-financed networks therefore is much greater than in the case of state aid in current generation broadband 'grey' areas and 'grey NGA' areas.

Notwithstanding this general assessment, the following comments address the specific conditions proposed in points 69 and 70:

- ***Crowding out of existing investments (point 69 and 70)***

As stated earlier in our response, ETNO believes that investments by telecommunications operators will assure an efficient development of NGA in member states. With a view to this, in case public intervention is granted for the development of NGA, it should not jeopardize efficient allocation of investment within the market. Funding by state authorities should never allow for a mere duplication of infrastructures, nor should it be granted in a non-symmetric way to some market players to the detriment of a well-functioning market.

To give private operators the legal certainty necessary to invest on a large scale in NGA networks, ETNO urges the Commission to follow the same approach as for "black areas", that is, explicitly state in the Guidelines that State aid should in principle be viewed negatively also in "grey areas". The draft guidelines, concluding only that a more detailed analysis is needed with regard to "grey areas", do not create the necessary legal certainty for investors upgrading their investments.

Black areas

ETNO welcomes the Commission's assessment that in areas where current broadband services are being delivered by competing broadband infrastructures (current black areas) no further State intervention is in principle necessary (point 72). Operators in these areas should have the incentives to upgrade their current traditional broadband networks, provided that the regulatory regime does not stifle these investments.

3. The time criterion for assessing the future investments in NGN (points 63, 64 and 69 relating to 'white NGA' and 'grey NGA' areas)

The Commission indicates that a time criterion for future likely investments should be taken into account, when assessing the compatibility of state aid for 'white NGA' and 'grey NGA' areas. Specifically, the Commission considers that white and grey areas will be evaluated considering the likelihood that an operator may deploy a NGA within five years. It should be specified that the time criterion to be considered should be the difference in time of NGA specific services between the widespread penetration in the market and the availability in the considered area. The definition of a five-year time period does not appear unreasonable but nevertheless should be considered with a certain degree of flexibility because it appears difficult to predefine a specific and predetermined time frame for investments in a market that is subject to a high degree of technological development and to uncertainty in the conditions of demand response to investments. In other words, it may be difficult to predetermine with certainty market players' plans of deployment over a long period. This criterion should be implemented more flexibly and adaptable to specific market conditions or to specific regional circumstances.

Final remarks:

ETNO would like to point out that another area which appears to require more in depth analysis in the Community Guidelines is the case of public/private partnership that could arise in projects for the deployment of NGN infrastructure in given areas of the member

states' territory. Public intervention may also assume forms that are different to "direct public funding". In some cases, governments or regional / local authorities may foresee –to allow for a faster deployment – the possibility to establish agreements, based on market principles, with infrastructure operators that plan to invest in network development (e.g. in the case of the state being a co-investor in the deployment of NGA). In such cases, given the respect of criteria for state aid funding and for the use of the financed infrastructure, public intervention could be seen as favorable to gap situations of digital divide or of citizens exclusion, provided that crowding out of private investment as well as devaluation of existing infrastructure is excluded."

ETNO is of the opinion that (in time) unlimited wholesale access to publicly owned infrastructures required in basic broadband black areas (para 74) should be extended to all NGA white regions. We see no reason why publicly owned subsidized infrastructures should have the possibility not to provide unlimited access.

ETNO would like to emphasize again the need for respecting the principle of technology neutrality. Incentivizing point-to-point (P2P) architectures (point 74), as well as multiple fiber solutions, is also contradictory to this principle. It could hinder investments in certain technologies (e.g., passive optical network (PON)) which are cheaper to deploy than P2P solutions. Moreover, as unbundling can take place at different levels, the requirement for technologies to be supported should be extended: an architecture that can be unbundled "at least at bitstream level" should in principle be sufficient (to be added to point 74, third bullet).

Finally, imposing wholesale access for at least 7 years is out of touch with the technological reality underlying the information and communications sector. Technology changes very fast and may dramatically alter operational assumptions. Different solutions lead to mutations in the market place, investment cycles tend to shrink and competition is more and more based on alternative infrastructures. Wholesale access should be mandate during a shorter period, no longer than 5 years.