



Liberty Global response to the Commission's consultation on its draft Community guidelines for the application of state aid rules in relation to rapid deployment of broadband networks

Liberty Global is the leading international cable operator offering advanced video, voice and broadband internet services to connect its customers to the world of entertainment, communications and information. Liberty Global operates next generation hybrid-fibre-coaxial (HFC) networks that serve approximately 16 million customers across 15 countries principally located in Europe, Japan, Chile, and Australia. Our European cable operations – branded UPC, Cablecom and Telenet - cover 10 EU Member States in both western and central Europe and include significant programming businesses¹.

This response is provided by Liberty Global Europe BV on behalf of itself and the other companies in its group (together LGI).

LGI is heartened that the Commission is seeking to provide Member States with policy guidance in an area where there are important but potentially competing policy goals such as: maintaining investment incentives for commercial broadband projects, while supporting the European economic recovery through encouraging a short run boost to infrastructure investment spending; and working towards bridging the digital divide while maintaining technology neutrality.

By the same token, we are concerned to see a range of projects and new initiatives across a number of the territories where we operate in which public funds are being made available for new broadband infrastructure projects. For example, in the Netherlands, generally regarded as the leading broadband nation in the EU in terms of broadband infrastructure coverage, price and speed, we note with concern a new potential wave of public funding initiatives in fibre projects enabled by the proceeds of the sale of shareholdings in energy utilities by of municipalities and provinces. Most recently the province of Limburg indicated to possibly engage in co-funding valued at € 100 million.² The Dutch Minister of Trade appears to have embraced such initiatives.

¹ www.lgi.com

² ANP press agency, 4 June 2009.

Whilst we agree public actors can make an important contribution to the roll out of NGAs in so-called 'white' and 'grey' areas, it is essential that such contributions (and hence the guidance provided to Member States in regard to such contributions) does not crowd out private investments and distort competition, particularly when public funding is being considered to be applied in already competitive and innovative broadband markets ('black areas'). It is vital that commercial operators such as LGI that invest in NGAs retain proper incentives to continue to invest in broadband both now and in future.

The guidance provided by the Commission should therefore incorporate and account for the important role commercial which operators such as Liberty Global have played and are continuing to play in creating a Europe of high speed broadband NGAs based on sustainable infrastructure competition. In every market where we have invested in cable NGN upgrade and, particularly, where we launched next generation broadband services³, this has precipitated a competitive response from other telecommunications operators and new investment in fibre based networks. UPC broadband's average CAPEX is 24% of revenues, while alternative operators invest about 19% and incumbents only approximately 15% of their revenues per annum⁴. For UPC, our CAPEX expenditure has been over 5Bn Eur in recent years, and investments will remain at this high level as we focus on high-bandwidth access via EuroDOCSIS 3.0 and next-generation networks.

The assessment of broadband investment projects under the State Aid rules is an ex ante assessment. Since investments in broadband project concern long term, irreversible, investments it is of utmost importance that the Commission has the proper means for an all-round ex ante assessment of state measures in this field.

Our comments include a number of suggested amendments to the Guidelines which would strengthen the ability of both the Commission and interested third parties such as LGI to scrutinise new broadband investments in sufficient detail. This includes such measures as a strong recommendation to notify measures even if it is claimed that the MEIP is fulfilled, a broader possible application of the stand-still provision and access to file for complainants.

³ Starting in summer 2008, UPC Netherlands launched 'UPC Fiber Power' giving subscribers surfing speeds of 60Mbps and 120 Mbps available across all of our Dutch network. In June, the Fibre Power internet portfolio was extended with speeds of 25, 30, 60 and 90 Mbps available, faster than any ADSL product on the market. At the same time UPC NL reduced their prices, to make Fiber Power products available to a wide audience. A new product Fiber Power 25 for EUR 25 was also introduced – See <http://www.upc.nl/internet/>. The 120M product was reduced in price from EUR 80 to EUR 70, and the 60M product from EUR 60 to EUR 40. We are also offering fiber power in other markets eg <http://www.upc.at/chello/>.

Other cable operators are also delivering 'next generation' broadband services with speeds of 100 Mbps include Welho in Finland, Numericable in France and Belgium, and VirginMedia and ONO offering 50 Mbps services.

⁴ Source 'The Cable Industry in Europe' produced for Cable Europe by Solon Management Consulting. To be published September 2009

By building in additional safeguards in the process and strengthening the role third parties are able to play, the Commission not only increases the quality of its decisions, but also strengthens investment incentives for private investors.

Our comments on the draft guidelines below should be understood in this broader context.

Definition of NGA broadband networks

We agree with the Commission's assessment that NGAs are defined as networks capable of delivering broadband access with enhanced characteristics compared with copper and include FTTC (vDSL), and cable upgrades to DOCSIS 3 (paragraph 46).

However, we strongly caution against too prescriptive a definition of NGAs being adopted for the purposes of broadband state aid assessments, in particular by reference to specific upload and download speeds. Given that the pace of the development of technology and service offerings is evolving rapidly, it is prudent for the NGA definition to be sufficiently flexible and broad in terms of possible network upgrades, and the range of technologies to be included.. This would also prevent potential inconsistencies with the electronic communications service (ECS) framework.

In addition we believe that footnote 44 regarding the capability of mobile networks underestimates the short-term capability of 3G, LTE, WiMAX and to some extent Wi-Fi networks for delivering NGA network speeds to end customers, and for competing with wireline broadband in the near term.⁵ As such we would welcome the deletion of this footnote and a re-statement of paragraph 45(d) that the NGA definition should be non-prescriptive and based on the principle of technology neutrality.

Assessing the Market Economy Investor Principle

The full and proper assessment of cases in which public authorities justify their financial involvement in a broadband project on the basis that it can not constitute 'State aid' because it conforms with the Market Economy Investor Principle (MEIP), should be seen as an essential of the Commission's strategy of ensuring that State aid does not distort private sector incentives for NGA investments. We are concerned that, with the approval of the Amsterdam Citynet case⁶, more local public authorities will be tempted to go down this path in already competitive broadband markets. We harbour major concerns that there will be an increasing number of new initiatives in the Netherlands in which local municipalities, in claiming to follow the 'Amsterdam-model', re-invest the proceeds of energy liberalisation in ftth networks with a view to competing with existing cable networks. We believe that the current ex-ante State aid assessment approach has exposed a number of important practical shortcomings

⁵ See for example the Digital Britain report published in June 2009.

⁶ Citynet Amsterdam decision 'No aid decision (after formal investigation Procedure) Case C 53/2006.

See European Commission press release IP/07/1889 at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1889>



in the assessment of conformity of public investments with the MEIP, thereby undermining legal certainty for private broadband infrastructure investors like Liberty Global that are already active in servicing customers in 'black' areas.

We believe that when a public authority, whether acting as part of a PPP or of its own accord, engages in the funding of a broadband project which it asserts to be in conformity with MEIP, there will always be a significant risk that in practice that the MEIP cannot be fulfilled. We feel that there is a significant enforcement gap in the system of State aid review if Member States are left to interpret and apply the MEIP at their own discretion, solely with a view to obtaining greater legal comfort. This leaves open the possibility of cases of (illegal) State aid taking place which have not received Commission scrutiny because they have not been notified.

Whilst we appreciate that the MEIP constitutes an exception to State aid rules, we call for the Guidelines to strongly encourage Member States to notify MEIP cases to the Commission, given the fact that the Commission is ultimately the arbiter of whether the investment accords with the MEIP, and the delicate questions of judgement that need to be considered in determining whether a government investment truly accords with the logic of the marketplace.

Moreover, when one considers the inherent difficulties in the ex post remedying of those situations where investments have started or have even been completed, the Guidelines should clarify that the stand-still clause, which is aimed to confer essential legal certainty to competing private infrastructure investors, should be both applicable and enforceable for projects that claim to be MEIP-compliant, depending on the particular merits of the case. As this clause has thus far been interpreted as applying exclusively to notifications of State aid for negative clearance, it has shown itself to have been easily rendered ineffective when one seeks to enforce it before national courts in a case involving an MEIP-related claim.

In such cases national courts may be hesitant to apply the clause in the case of public private partnerships, since in those cases it cannot be excluded that the Commission might consider public participation not to constitute State aid.

In our view, one could also argue that it cannot be excluded in such cases that the Commission reaches the conclusion that the PPP construction fails to comply with the MEIP and therefore does constitute State aid. Failure to make the stand still clause applicable will therefore lead to the creation of a 'fait accompli' since the construction of NGAs cannot be halted effectively, even if it would be (highly) questionable that the MEIP applies.

The history of the Amsterdam Citynet case shows that this is not merely a theoretical issue. Application of the stand-still clause to the Citynet project was invoked before the Amsterdam District Court. Despite the fact that the Commission had, during the serious doubts phase, repeatedly called upon the 'stand-still' provision to be applied to the case, the Court chose to ignore it, possibly because the stand-still provision is not explicitly applicable to MEIP projects in the absence of a negative clearance

procedure being available for such projects, similar to the procedure for notifiable State aid.

Critical to an assessment of whether the MEIP is satisfied is the consideration by the Commission of the Business Plan adopted by the local authority and the significant participation of private investors, both elements of which should be submitted as an integral part of the notification.

We therefore strongly believe that paragraph 19 should be amended to reflect the Amsterdam decision so that the MEIP compliance criteria are satisfied cumulatively i.e. significant participation of a private investor and the existence of a sound business plan⁷. In particular, when considering black areas where there is no market failure by definition, these conditions for MEIP compliance should be applied very restrictively in order to preserve infrastructure competition, to maintain the NGA investment incentives for private investors, and to avoid excessive risks taken with public funds that could be better spent on bridging digital divide.

We support the Guidelines in their commitment that the conformity of a public investment with market terms should be “demonstrated thoroughly and comprehensively”. In this respect, and in light of the Amsterdam decision, we take the view that, based on sound market investment practices, the following conditions should be considered to be indispensable when reviewing a Business Plan in the context of the MEIP:

- **Significant & Con-comitant Participation:** It is essential that investments by the private market investors are significant in relation to the total cost of the project and to the input by the municipality. In addition, financial participation of private and public partners need to be made at the same time and on the basis of a joint business plan, which is objectively sound and contains identical terms and conditions for all PPP parties and where any pre-investments by the public partner are discounted in a transparent manner (see below).
- **Pre-investments** by public authorities prior to the establishment of a public private partnership should always be reviewed as part of the business plan assessment. In certain circumstances, pre-investments can have the effect of reducing the start up risk for the private partners, or losses incurred in this phase being inequitably absorbed by the public authorities. In order to avoid distortions of competition by giving private partners in a PPP an unfair competitive advantage, the terms and conditions for the pre-investments, as well as the financial commitments of all partners in view of paybacks etc. should be contractually arranged and submitted as part of the notification to the Commission. Our understanding is that the issue of pre-investments has only been ‘repaired’ in the Amsterdam case after the Commission opened an

⁷ ‘The conformity of a public investment with market terms has to be demonstrated thoroughly and comprehensively, for instance by means of significant participation of private investors and the existence of a sound business plan.’ *Norbert Gaal, Lambros Papadias and Alexander Riedl: Competition Policy Newsletter 1/2008*, page 85, at http://ec.europa.eu/competition/publications/cpn/cpn2008_1.pdf

in-depth inquiry, following a complaint by LGI. Such a procedure allows for a significant degree of commercial 're-engineering' to occur, and the MEIP to be abused.

- **Return on investment:** It is important that the Guidelines are more transparent as to whether different rates of return are considered permissible for the purposes of fulfilment of the MEIP. For example, in the Amsterdam decision, the Commission found CityNet's business plan to be within market expectations for companies active in the telecommunications market, though it noted that the characteristics of the project meant the rate of return was assessed on the basis of a (passive) infrastructure (real estate) type of investment, for which a lower IRR would be required than for a vertically integrated telecommunications operators.
- **Burden of proof:** The Guidelines should establish that the burden of proof regarding the robustness of the business plan rests with the public authority. In assessing the robustness of business plans by the Commission, we would strongly recommend the Commission to undertake ex post evaluations of past cases to obtain an informed and realistic view for the assessment of critical business model parameters. In the Amsterdam case for example, the public information available suggests that the business plan submitted has likely been overly optimistic, especially in terms of the anticipated subscriber take-up rate (penetration), which is a critical success factor for a market investor.
- **Safeguarding third party rights:** Where a joint-venture is notified to the Commission in which public authorities justify their financial involvement in a broadband project on the basis that it can not constitute 'State aid' because it conforms with the Market Economy Investor Principle (MEIP), this should automatically confer review under the merger control regulation. This would confer to complainants and other interested parties with standing the ability to challenge assumptions made in business case of the public actor, propose supporting benchmark evidence and benefit from confidential access to the file. It would assist the Commission in improving its assessment of the business case put forward through receiving relevant input from interested parties that are (more) familiar with local market conditions.
- **Monitoring:** In line with merger review remedy monitoring, in cases involving an assessment of the fulfilment of the MEIP, the Commission should have monitoring powers with regard to forward looking business case assumptions, in particular on the assumption on how anticipated losses are being shared between the public and private partners. Particularly, where it can be shown that actual facts (e.g. known penetration rates, pricing levels, speed of penetration) fail to meet the assumptions made in a business plan, the Commission should require evidence of the PPP about losses made and how these losses are being divided.

We consider that a mistaken approval of overly optimistic business plans by the Commission to be a genuine risk, which may potentially lead to significant distortions of competition.

For example, once projected penetration rates fall behind projections, operators of infrastructures that are (co-)financed by public authorities will have a strong incentive to lower prices and effectively operate below costs. Alternatively, failed projects may be written off and sold for a price significantly below the original investment. It will be very difficult to repair such situations *ex post*, which hence underlines the importance that should be attached to a detailed and thorough *ex ante* assessment.

White, grey and black areas

We fully support the conclusion reached in 39, in which *'state support for the deployment of broadband networks in 'grey' areas calls for a more detailed analysis and careful compatibility assessment'*.

It is precisely the definition of grey areas, we believe, which presents the most challenging conditions for application of the State aid rules. On balance, we believe retaining the distinction between 'white', 'grey', and 'black' areas is appropriate for the NGA context, with one major clarification; the draft Guidelines do not in our view sufficiently take into account instances where public municipality projects funded by state aid cover areas which comprise 'white', 'grey' and 'black' areas.

We believe the Guidelines must give greater consideration to the issue of overlapping areas. In these hybrid areas the assessment of whether a measure constitutes State aid must consider the likelihood that a grey area will in a reasonable time frame become a black area given the existence of competitive market developments. Where a project is found to be of a truly hybrid nature, it should only be approved where the area under consideration is white or grey in nature. Where the State aid is targeted at black areas we fundamentally support the Commission's conclusion in 2.3.2.2: that there is no need for State intervention.

Timing of private NGA investment and compatibility with the State aid rules

We are concerned that the Guidelines favour artificial and uneconomic timing triggers, which if met, would, according to the draft Guidelines, indicate a lack of likely short term private sector investment in NGA, and may result in a positive assessment of the compatibility of the aid.

Evidence of these artificial and short timing triggers feature throughout the Guidelines⁸. In particular, and for the purposes of defining white and grey area in an

⁸ Paragraphs 5 and 7 refer to achieving a higher level of broadband coverage "in a more timely manner" and supporting the "rapid and timely" roll-out of NGA networks, respectively. Paragraph 55 characterises aid as accelerating the investment cycle.

NGA context, paragraph 63 defines entry of private NGA investment 'in the near future' as a period of not more than 5 years.

It is our contention that the feasibility of private investor entry into NGA infrastructure projects should not be based on artificial timing constraints, as there are a range of competing factors which the private market operator must consider in developing a business case for an NGA investment.

Based on the average time it takes to deploy a NGA network in a town or city, the guidelines propose 5 years. The timing of private market operator investments, on the other hand, is determined by a range of factors such as the size of the area covered, population density, the number of expected customers and the demand forecasts.

The anticipated timing of private NGA investment is made more complicated when the target area for a municipal funded project comprises a mix of white, grey and black areas. In these circumstances, private operators are unlikely to deploy an NGA across an entire city, but will focus on central parts, or the grey and black areas, first. However, if the State aid assessment covers an entire city or municipality area, it is highly unlikely that NGA investment across the entire area will occur within a period of 5 years. Since the Commission's draft Guidelines do not address in detail the scope of the term "substantial part of the territory", it is unclear how the Commission would apply its Guidelines in such hybrid cases.

For these reasons, we believe that the use of such relatively short timeframes to consider private operator investment in NGAs would unnecessarily complicate the tasks of the Commission and overly simplifies the types of investment decisions private investors face. Using these relatively short timeframes would, in our view, artificially and unwittingly increase the likelihood of state intervention.

Guidance for NGA build must sustain the working premise that state aid is the last resort in clear cases of market failure, and not a mechanism for accelerating the pace of NGA investment.

We therefore suggest that these timelines be adjusted depending on the scope of territory being assessed. For grey and black areas, we recommend that the term "in the near future" correspond to a time span between at least 7-10 years, allowing for greater flexibility and certainty. It is imperative that the ability of operators to raise commercial funds to support network roll out is not undermined by State intervention that artificially dictates the timing of investment regardless of differences in business case planning for white, grey and black areas.

Public authority's assessment of compatibility with State aid rules

Market analysis (paragraph 45a)

Whilst we support the introduction and use of a rigorous market analysis procedure to assess the proportionality of a notified measure in white and grey areas, the standard of such analyses must be comparable in quality, economic rigour and breadth to those undertaken by NRAs in the context of ex-ante electronic communications regulation under the 2003 EU regulatory framework. Accordingly, these market analyses should be undertaken in close cooperation with national electronic communications regulators and national competition authorities. Similarly to the guidance given by the Commission to NRAs to apply market analysis to a list of pre-defined 'relevant markets'⁹, we recommend the Commission issue similar guidance to Member States for their self-assessment of State aid broadband projects.

Assessing historical investment in black areas (paragraphs 72 & 73)

In reaching an assessment of NGA infrastructure build in black areas, the Guidelines correctly establish the principle that State aid in principle should not be necessary in such areas. However, in paragraph 73 the Guidelines propose that where the historical pattern of the investments made by network operators has not been satisfactory, Member States can challenge this principle.

In our view, and in light of our earlier comments on timing, the use of (short) timeframes to consider private operator investment in NGAs oversimplifies the process by which private market operators consider NGA build. We also have major concerns that a public sector analysis of historic investment by existing infrastructure providers in broadband is not an appropriate indicator for future investment in NGA. Firstly, it pre-supposes a high level of economic analysis skills on the part of public authorities, without giving any guidance on what time frame is to be considered, what the supply and demand conditions were at the time of investment etc.

Secondly, it makes the assumption that where 'unsatisfactory' investment in infrastructure to provide higher speed broadband has taken place, the state is justified in intervening in the market. In our view, as regards NGAs and black areas, the Guidelines must take as their starting point that State aid is the last resort in clear cases of market failure, and not a mechanism for accelerating the pace of NGA investment. Private economic operators may not have invested in the past because of a (perceived) lack of demand, or because of major changes in economic or regulatory conditions. Reaching a conclusion that unsatisfactory investment has taken place historically based on an administrative assessment risks in our view constitutes an imprecise and arbitrary approach that suggests a favourable stance towards State aid and an underestimation of the efforts of existing infrastructure owners to upgrade their networks to accommodate growing demand. Indeed, as

⁹ Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (Second edition) Brussels, C(2007) 5406 rev 1.

indicated in paragraph 72, the strong assumption should be that, in order to remain competitive, operators can be expected to continuously upgrade their networks and services to meet demand from customers. More significantly, the approach overlooks the fact that markets evolve quickly, and economic operators react quickly to changes in investment conditions for example to take advantage of new demand or to changes in regulatory or economic conditions.

We therefore recommend paragraph 73 is suppressed as we do not consider that there is a sub-market in black areas where special conditions apply.

Wholesale access to traditional broadband – Paragraph 45(f)

In assessing the proportionality of the proposed minimum 7 year wholesale access obligations proposed for state aid funded broadband infrastructure in white and grey areas, we urge Commission policy to be consistent with that of the EU regulatory framework.

In particular, it is essential that wholesale access pricing does not in the longer term create distortions that either strand or devalue past investment by private operators, or which create an imbalance in incentives which favour non facilities-based competition. If wholesale prices are set at artificially low levels, competition with privately financed NGA networks is likely to suffer, and there is likely to be greater demand for NGA projects requiring state funding.

Wholesale access to NGA networks (paragraph 74(2))

Consistent with our comments above, the requirement to provide wholesale access to subsidised networks in grey NGA areas for a period of at least 7 years, should be assessed against the longer term effects of the pricing of this access. In particular the price levels should either strand or devalue past investment by private operators, or which create an imbalance in incentives which favour non facility based competition.

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