

“Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks”

OBSERVATIONS BY MEDIASET S.P.A.

Introduction

- (1) Mediaset welcomes the opportunity to provide comments on the European Commission’s Consultation Document “Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks” (hereafter the Guidelines).
- (2) Mediaset agrees with the aims, the principles and the general spirit of the Guidelines, and it concurs with the Commission’s goal to provide clear guidance on how it will assess any public intervention in the broadband field.
- (3) Mediaset fully shares the Commission’s view on the application of the State Aid rules for measures aimed at promoting the deployment of traditional broadband networks in scarcely populated areas. However, with regard to the assessment of the State interventions in the deployment of Next Generation Access Networks (hereafter NGANs), Mediaset reckons that State Aid may severely distort competition with services that are delivered through different technological platforms.
- (4) Mediaset is not opposed to public funding for NGANs and acknowledges that these networks can fulfil a social and economic need. State intervention should, however, not confer an advantage to one or more operators that may cause unwarranted distortions to competition.
- (5) Although the Guidelines provide a good discussion of the conditions under which state interventions are possible, Mediaset believes that some issues should be further clarified and underlined, namely:
 - the conditions for identifying the presence of a market failure that needs to be addressed through public intervention;
 - the potential distortion of competition that State Aid measures in favour of telecom operators may trigger on alternative platforms; and
 - the regulatory safeguards that should accompany the granting of State Aid to private companies for the roll-out of NGANs.

NGANs and market failure

Is there always a scope for public intervention?

- (6) The Guidelines state that “public authorities should be entitled to intervene” where NGANs do not exist at present (the so-called white areas) and “private investors have no intention to deploy NGANs in the coming [5] years” (par. 63).
- (7) These criteria seem to be based on the assumption that the absence of planned investments in NGANs over a given time-frame always identifies the presence of a market failure. However, the simple fact that there are no investments in NGANs is not sufficient to presume that the market is not working well and that a public intervention is necessary.
- (8) To identify a market failure, it is necessary to prove that the market will not deliver investments in NGANs because private operators do not fully internalise all the benefits that would result from a fast and extensive deployment of these networks and therefore consider that the return they can derive from these investments does not compensate the relative costs. These benefits are referred to as positive externalities.
- (9) When there are externalities, the market may not deliver the outcome that maximizes social welfare and a public intervention may be necessary. However, the Guidelines do not explain which externalities could be derived from a fast and extensive roll-out of NGANs, nor do they stress that their identification represents a key step in the evaluation of whether State Aid could be granted.

- (10) On this point it is worth highlighting that OFCOM, which has undertaken an in-depth analysis of the potential contribution of next generation networks to social and economic value¹, claims that whether the deployment of NGANs suffers from this externality problem is widely unclear².
- (11) At this stage, it seems more likely that the slow pace of investments in NGANs is due to a lack of demand for services that require high and symmetric bandwidth coupled with the high costs of their roll-out.
- (12) Indeed, the level of the demand for applications requiring NGAN's capabilities is still uncertain. Moreover, the potential of the existing copper access networks does not seem to have been exhausted and these networks appear adequate to deliver most of the services currently required by customers.³ This is consistent with the Appingedam Decision (case Comp/C.35) where, in response to the Dutch authorities' argument that future content services and applications need networks with a higher capacity, the Commission stated that "it is difficult to envisage mass-market applications in the near to mid-term future which cannot be delivered over the existing networks. This means that the degree of substitutability between services delivered over "next generation networks" vis-à-vis existing networks is high and therefore the potential distortion of competition by the measure will remain high for the foreseeable future" (par. 79).
- (13) Moreover, the costs of rolling out NGANs are very high and, therefore, the uncertainty with regard to the level of demand for the services these networks can deliver makes these investments highly risky. Hence, the operators' cautiousness should not necessarily be regarded as evidence of a market failure, but it may actually be proof of the fact that the market is holding firms from making investments whose expected net social value is still negative.
- (14) Other reasons may also be affecting the timing of the NGANs' roll-out, such as the potential of existing technologies and the level of penetration of other platforms. For example, OFCOM recognises that the slower deployment of NGANs in the UK compared to other countries is due to differences in commercial and geographical factors. In particular, OFCOM maintains that in other countries: (i) existing broadband services are less able to meet customers' needs; (ii) there is greater scope for entering the pay TV services, which is already a very mature and competitive sector in the UK; (iii) deployment costs are lower because of the presence of more densely populated urban areas. According to the OFCOM, these differences imply that the efficient deployment of next generation access is happening faster in some countries than in the UK, but that does not mean that UK will be significantly disadvantaged economically or socially.⁴
- (15) In conclusion, there may not be a market failure.
- (16) For the reasons discussed above, Mediaset believes that the Guidelines should identify clearly what are the sources of externalities that may justify a public intervention to speed up and sustain the roll-out of NGANs and require Member States to consider granting State Aid only if such externalities are present. The risk of endorsing inappropriate public interventions is very high because State Aid may undermine the incentives of market operators to invest in NGANs (par. 5) and may thus distort competition between firms.

Do investment in NGANs always involve high risks?

- (17) Whereas for the roll-out of basic broadband infrastructure the Guidelines clarify that state intervention have to be mainly related to rural communities/areas or areas which are underdeveloped (par. 51), with respect to the deployment of NGANs, the Guidelines seem to suggest a different and more lenient treatment of State Aid measures. This would be justified by the costs of roll-out that are said to be too high in relation to the revenue that can be expected, thereby discouraging investment

¹ Ofcom (2007) "Future broadband Policy approach to next generation access."

² "Evidence of the existence of positive externalities in next generation access markets is lacking at present", Ofcom (2007), cf. supranote 1.

³ In the near term, investments to upgrade backhaul and core networks might be more important to carry faster broadband services.

⁴ Ibid.

in next generation networks not only in sparsely populated areas, but also in certain urban zones. We disagree with the view of the Commission.

- (18) First, expected revenue might still be low because the demand for high-speed services has not yet emerged and hence consumers are not willing to pay in excess for services they do not yet feel the need to purchase. The high uncertainty related to the long-term evolution of the demand induces private operators to heavily discount future profits thereby reducing the overall return expected from the investment in NGANs roll-out. This phenomenon is common to most new technologies and does not necessarily identify a market failure. Indeed, as the demand materialises the prospect of future revenues is updated and so is the overall viability of the investment.
- (19) Second, recent studies on the costs of deploying NGANs⁵ show that such costs in more sparsely populated areas will be significantly higher than in urban and more populated areas. Even OFCOM⁶ in its 2007 Consultation on “Policy approach to next generation access” recognises that NGANs are more likely to be deployed in densely populated areas. This is consistent with the current international experiences: operators are indeed following an incremental approach, starting the roll-out from the urban and more densely populated areas similarly to what happened with first generation broadband networks. Economies of density seem thus to play a role also in the roll-out of NGANs. The extent of such economies in NGANs largely depends on the technology adopted, whether fibre – cable - or wireless-based (and even within the fibre-based solutions operators face different options ranging to FTTE, to FTTC and FTTH), but they are nonetheless one of the main factors driving the investment decisions of operators.
- (20) In conclusion, there are no signs that NGANs require a more lenient treatment than existing ones. Episodes of underinvestment in NGANs are more likely to occur in rural and economically underdeveloped areas as for first generation broadband networks. Public intervention should therefore be more concerned with digital divide issues arising from a patchy deployment of NGANs rather than with the lack of NGA investment altogether.
- (21) Finally, as for the lack of broadband coverage in some areas, the Guidelines should explicitly acknowledge that alternative policy options are available. In particular, it is worth stressing, as recognised by the Commission,⁷ the potential role of universal service obligation (USO) as a tool to advance broadband development. It goes beyond the scope of this response comparing the likely impacts of State Aid measures against USO, nonetheless we wish that the Commission takes this point into account in the final document of the Guidelines.
- (22) NGANs and alternative platforms: may the State Aid measures distort inter-platform competition?
- (23) We believe that the Guidelines should stress more heavily the risk of potential distortions that public intervention in the roll-out of NGANs could cause to inter-platform competition.
- (24) This issue is of particular concern for the broadcasting market. Pay-TV services belong to the same relevant market regardless of the platform on which they are delivered (be it satellite, cable, digital terrestrial or broadband), as recognised by the Commission⁸ and several national authorities. If State Aid is granted only to one platform, i.e. broadband, this can cause significant distortion of competition in the pay-TV market.
- (25) First, public subsidies for the roll-out of NGANs may modify the relative costs of the provision of TV services delivered through different platforms and, as a consequence, their competitive strength. Public subsidies may, indeed, allow to develop NGANs, as they would lower the cost of entering the

⁵ Analysys Mason (2008), *The costs of deploying fibre-based next-generation broadband infra-structure*, Final report for the Broadband Stakeholder Group, 8 September 2008

⁶ Ibid.

⁷ The Commission is planning to launch a public consultation on the future of USO in relation to broadband/high-speed services. Central to this Consultation will be whether universal service at the EU level is an appropriate instrument to foster broadband development and its relative effectiveness compared to other EU policy tools.

⁸ See, for example, Commission decisions *BSkyB/Kirch Pay TV* (case COMP/JV.37) and *Newscorp/Telepiù* (case COMP/M.2876)

broadcasting market. In other words, they may create an artificial advantage for the provider of services via NGANs to the detriment of alternative platforms.

- (26) Second, the operators of other platforms have invested, and are still investing, in infrastructure. Any public financial support to NGANs might, therefore, reduce the economic value of past investments and deter new investments in competing networks. This would be in contrast with the general principle, endorsed by the Commission, of technological neutrality and its related goal of fostering facility-based competition.
- (27) Third, the TV sector has the features of a so-called two-sided market. In a two-sided market, there are two distinct user groups that provide each other with network benefits, so that the growth of one side of the market is likely to influence the growth of the other side. Given the two-sided nature of the pay-TV market, the competitive advantage granted to a specific platform through State Aid may be self-reinforcing and, thus, may generate long-lasting distortion of competition.
- (28) These arguments are consistent with the reasoning followed by the Commission in the Berlin-Brandenburg decision (case C.25/2004)⁹, where subsidies for DTT broadcasters have been considered incompatible with the common market. The same logic, *mutatis mutandis*, should apply to the assessment of State Aid measures for NGANs, as both DTT and broadband networks deliver retail services that compete in the same market (i.e. broadcasting services).
- (29) We agree with the Commission that in the future NGANs will deliver services of high social value that existing technologies and platforms cannot provide (e.g. healthcare services, such as telepathology, telesurgery, remote patient monitoring, and education and research services, such as distance education, virtual classes and laboratory). However, so far, TV services such as IPTV and HDTV have been identified as one of the key drivers of the demand for higher bandwidth access services¹⁰ and the incremental positive externalities of these services when delivered on NGANs with respect to other platforms are highly questionable.
- (30) In conclusion, the Commission should highlight more strongly the risk that State Aid measures for the deployment of NGANs may distort inter-platform competition and should encourage Member States to be much more cautious in assessing the possible costs of these interventions.

State aid to NGANs and regulatory safeguards

- (31) Although extreme caution should be taken in granting any aid for the roll-out of NGANs, there may be cases in which such aid may prove appropriate. In these cases, the Guidelines should insist that Member States choose a form of aid that is less likely to distort competition. In particular, the Guidelines should stress that a lesson should be drawn from the experience of the telecommunication sector's liberalisation.
- (32) The telecommunications sector in most countries is characterised by the presence of an ex-monopolist which controls the only country-wide network. Even though, in recent years, extensive regulation of wholesale access to this network has achieved substantial results in creating a level playing field for retail competition, the problem of lack of equality of access is not yet fully solved. Indeed, as the international experience shows, access regulation has not succeeded in completely addressing the risk of discriminatory behaviours. And, a number of countries have imposed or are considering some form of structural or functional separation to solve this problem. It would be a major error not to learn from this most meaningful experience.
- (33) Adequate competition in the provision of NGAN-based services must be pursued by ensuring that all providers of services that require broadband access are able to buy the same wholesale products at the same commercial conditions. In order to overcome this problem and to effectively achieve the Equivalence of Input principle, it is necessary to have structural separation between retail companies and the network operator. Only structural separation can reduce the incentives for price and non-price discrimination, thereby ensuring a level playing field.

⁹ Case C25/ 2004, *Germany - DVB-T in Berlin-Brandenburg*.

¹⁰ See Ofcom (2007), *supranote 3*.

- (34) In this respect, the measure adopted by the French Government in the Pyrénées -Atlantiques case¹¹ should be regarded as an example of best practice in the field of public schemes in favour of the development of broadband networks. In this case, the construction and the management of the state-funded network has been delegated to a subsidised private company which can only sell wholesale products to telecommunication companies for the delivery of high-speed services to end-users, and cannot operate directly in the retail market. This scheme clearly separates the network operator from the retail companies, thereby removing any incentive for the former to discriminate.
- (35) Mediaset recommends that the Commission endorses this approach as the most suitable to avoid that potential benefits to consumers from NGANs are curbed by the emergence of market power issues at access level (par. 54-59).
- (36) Whenever the previous option cannot be implemented, the Guidelines should suggest the implementation of a structural separation between the wholesale arm (i.e. the one that runs the NGAN) and the retail arm, as a prerequisite for granting public funds to a private company for the deployment of a NGAN.

Conclusions

- (37) Mediaset welcomes the opportunity to comment the Commission's Guidelines for the application of State Aid rules in relation to broadband networks. These Guidelines represent a significant step forward in defining a clear framework to assess the compatibility of State Aid measures in favour of the deployment of first generation and new generation broadband networks. The document's aims and general spirit are much appreciated.
- (38) However, as far as public interventions for the roll-out of NGANs are concerned, a more cautious approach should be pursued, in order to avoid the high risk of distorting competition and jeopardising the investments made to date for the deployment of alternative platforms. In particular, it would be advisable that:
- a. The Commission should provide clearer indications on how to identify the presence of elements of "market failure", i.e. externalities, because if such elements are not present, State Aid should not be granted and all investments should be market-led. The Commission should consider explaining what kind of externalities would justify the use of public money to support the NGANs .
 - b. More emphasis should be put on the risk that public aid targeted to broadband networks may place providers that employ alternative platforms at disadvantage. This issue is most sensitive in the case of audiovisual retail services, as they all belong to the same relevant market, regardless of the delivery platform. Since, to date, high-quality audiovisual applications constitute the main driver of the need for higher bandwidth access services, it is essential to consider the impact of State Aid on competition in the retail market for these services.
 - c. If it can be proved that the provision of State Aid to private companies is appropriate and that its benefits outweigh any cost it may impose, the Commission is right in suggesting that adequate regulatory safeguard are put in place to prevent the emergence of market power in the provision of access to the NGAN. Nevertheless, the Guidelines should also recognise and stress the importance of requiring some form of structural separation (either by granting the aid to a company which is only entitled to operate the network or by imposing structural separation between the wholesale and retail arm of the recipient company) to minimise the impact on competition of the State Aid measures.

¹¹ Decision N. 382/2005, *Projet de réseau de télécommunications haut débit des Pyrénées-Atlantiques*.