



EUROPEAN COMMISSION

Brussels, 20.07.2004

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Subject: State aid N 213/2003 – United Kingdom
Project ATLAS; broadband infrastructure scheme for business parks

Sir,

I. Procedure

1. By letter dated 20 May 2003 the United Kingdom authorities (hereinafter: UK authorities) notified the Commission of the above-mentioned measure. The Commission asked for additional information on 4 July 2003. The UK authorities replied by letter on 31 July 2003. By letter of 3 September 2003, the Commission posed additional questions. On 18 September 2003 a meeting between the UK government and the Commission took place. The UK authorities provided the missing information on 29 October 2003.
2. The Commission had previously received, on 12 March 2003, a complaint regarding the above-mentioned project by THUS Plc, which is one of the UK's providers of voice, data, Internet and interactive services. A meeting with THUS took place on 18 November 2003.¹ The Commission also received on 10 December 2003 an additional complaint from an Internet Service Provider operating from Scotland.

* In addition, a complaint was received from another operator on 24 March regarding two related aspects of the ATLAS project: the so-called phase I, concerning a Telecoms Trading Exchange (TTE) and phase IIa, concerning the London- Edinburgh backbone. Those aspects, however, are not dealt with in the present decision.

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3. On 24 November 2003, the UK authorities notified a modification of the project. This modification paper was discussed with the UK authorities on 27 November subsequently. On 19 December 2003 the Commission posed supplementary questions. After a further meeting was held on 17 March 2004, the UK authorities submitted their answers on 25 March 2004. On 25 May 2004 the Commission asked further question to which the UK authorities replied on 30 June and 8 July.

II. Detailed description of the measure

Outline of the project

4. The notified project refers to the so-called phase IIb of the ATLAS project. Initially, this project consisted of the creation of a local backhaul (park to node) and the procurement of the regional backhaul (connecting the nodes in different cities with each other and with Edinburgh). It also foresaw the funding of an 'active' infrastructure, i.e. light transmission and amplification equipment which transmits, guides and boosts light wave signals, and equipment necessary to provide IP connectivity. The project envisaged also an Operating Manager which would operate the local and regional backhaul segments of Project ATLAS.
5. With respect to its initial design, the modified Project ATLAS, as notified on 24 November 2003, implies a substantial downsizing in its geographical, technical and operational scope. The modified project ATLAS is aimed at lowering prices of broadband services for commercial users located in business parks. The project will be geographically limited to providing infrastructure on business parks. Technically, the infrastructure will comprise only "passive" infrastructure (ducts, chambers, fibres and Meet-Me-Rooms) and no longer the "active" infrastructure.¹ Operationally, the asset management, the maintenance and the leasing of dark fibre will be outsourced to an Asset Manager. It will provide neutral access on a non-discriminatory basis for service providers at an appropriate point on, or close to the perimeter of each business park. There is no longer a need for a new Operating Company.

Procurement aspects

6. The invitation to design, build and operate the ATLAS network was solicited from the open market through a negotiated procedure for services.² The UK authorities, however, have taken the view that as bids were sought and evaluated on the basis of the initial Project Atlas, the modified project should proceed on the basis of a fresh competition in accordance with EC rules and principles on public procurement. Accordingly, the authorities have committed themselves to re-tendering the modified Project Atlas in accordance with EC rules and principles on public procurement. The present decision is based on this commitment.
7. The preferred bidder will manage the assets on behalf of Scottish Enterprise (hereinafter: SE), which will remain the owner of the assets, and lease capacity to

¹ "Meet-me rooms" are facilities where telecommunication carriers and network service providers gather to cross-connect. They are purpose-built, shared resilient rooms where carriers can situate fibre racks and other switching technology.

² Negotiated procedure for services (ref. no. 2002/s 59 046302).

whole sale operators and/or Service Providers (hereinafter: SP's) on a transparent, open access and non-discriminatory basis.

8. The modified project ATLAS intends to utilise existing fibre telecom infrastructure wherever practicable. Existing fibre owners who already have fibre on the parks will be given the opportunity to supply dark fibre. This will be achieved through an open and transparent procurement process and will be carried out by the Preferred Bidder/Asset Manager, i.e. the undertaking responsible for the delivery of the overall project. If existing fibre is offered on appropriate commercial, technical and legal terms, the ATLAS project will not require building duplicative infrastructure in these locations.

Financial aspects of the project

Costs

9. At this stage the overall costs of the dark fibre network and the Meet-Me-Rooms (MMR's) is estimated to be about £9.7 million (€ 15 million). In addition, the operating costs of around £ 300 000 in the first two years have been assumed. In subsequent years this has been scaled back by 30% to reflect a reduction following the start-up phase.

Rate of return

10. According to the authorities, the rate of return for the modified Project ATLAS is estimated to lie in the range of 3.4% to 9.2%, depending on variations in the key revenue and operating cost assumptions. The base scenario is 6.9%. The UK authorities indicate that the investment by the public sector in ATLAS is aimed at wider economic benefits to the Scottish economy and not purely at making a return on capital invested.

Revenues

11. The infrastructure will be leased to telecom service providers on the basis of 1, 5 or 10 years contracts. The pricing will be open and transparent (published on a publicly available list). A connection fee and an annual fee for access to the dark fibre and the MMR's will be paid by each Service provider to the Asset Manager.
12. The Asset Manager will offer the use of the infrastructure to the SP's for a price which depends on the businesses the SP's intend to serve. The SP's will obtain a lower price for capacity needed to serve small to medium sized enterprises (SME's). An indicative price for access to medium sized businesses will be set at a multiple in the range of 6 to 10 times greater than the figure for small businesses. The prices will be determined by SE. Hence, the UK authorities assume that Project ATLAS will take a high market share of the small and medium business segment but have a relatively low market share of the large business segment. The SP's will also be obliged to charge the same price for each connection from the MMR's to each customer premise, irrespective of which park the customer is located in, or the distance from the MMR's.
13. The proposed amortisation is for all assets (ducts, fibre and MMR's) to be written-off over the 25-year life of the project. There is no requirement for replacement capital expenditure.

III. Observations of third parties

Observations of complainants on the initial project

14. In its complaint of 12 March 2003, THUS Plc addressed the ATLAS project as specified in the original plan. It indicated that: *“No enterprise can object to the arrival of more competitors: competition is a wholesome force, which benefits both consumers and those who compete. The concept of the creation of infrastructure within Scottish business parks by Project ATLAS therefore cannot be objected to. However, the question to be considered is whether Project ATLAS involves the creation of an additional telecoms operator through public funding not made to pursue financial goals which are normal in this marketplace, but in order artificially to create the subsidised competitive presence of a new entrant”*.
15. The complainant considered that there was little sense for State intervention where competing services were already available and those competing services were able to operate profitably.
16. It argued that the project would not be done on market terms: *“the best measure of the market rate of return is the weighted average cost of capital (WACC) for telecoms operators: there may be other measures, but they would probably yield comparable results. UK telecoms operators’ WACC is currently in the region of 15% to 20%. [...] The regulated rate of return for BT (which of course has a far lower level of risk, given its position as an incumbent) is about 13%”*.
17. The complainant also described the market for business telecom services as involving three submarkets: Wholesale regional backhaul, Last mile access in business parks and Retail business services (voice and data). It then expressed its concerns as follows:

“THUS is particularly concerned about distortion to the regional ‘backhaul’ market. Telecoms service providers often purchase capacity from other telecoms operators when their own network does not extend as far as the customer. This form of trading between telecoms operators or service providers is referred to as a ‘wholesale’ market. Project ATLAS will compete on two distinct wholesale markets: the market for ‘last mile’ access from a node outside the business park to the customer’s building; and a regional backhaul market connecting the nodes in different cities with each other and with Edinburgh. Any new entrant receiving a hefty subsidy from the state will be able to offer prices much lower than those of its competitors who are generating a normal market rate of return.”

and

“This market for last mile access is the only level in the value chain where it may be argued that there is partial market failure. However, this market failure has already been addressed by the UK telecommunications regulator, OFTEL, through a requirement on BT to provide cost-based access to its copper loop infrastructure (‘Local Loop Unbundling’) and a requirement to provide cost-based access to capacity on its fibre infrastructure (‘Partial Private Circuits’).”

Concluding that:

“...there is no evidence of a lack of competition. There is no market failure that needs to be addressed, at least in relation to the telecoms services offered to the 13 business parks”.

18. In a letter of 10 December 2003, the European competitive telecommunication association (ECTA) expressed support to the complaint of its member THUS plc.
19. According to the second complainant, the demand for IP infrastructure is greatest in urban centres. Servicing business parks as a priority is likely to disadvantage all other locations and leave the majority of businesses, spread through out the urban centres, with a disadvantage. The complainant also questioned the forecast of demand made by SE, suggesting that the project would not show a reasonable market rate of return and would become a “white elephant”. It finally expressed its concerns on the impact of the ATLAS project on the internet capacity backhaul market.

Observations on the revised project

20. THUS plc had the opportunity to comment on the revised project. It maintained that the revised project remained a State aid and explained that the cost of telecommunications infrastructure is dominated by the cost of digging and laying ducts. Hence, the average cost per end-user connection varies widely with the density of customers and the remoteness of the location. It argued that Telecoms operators will only have an incentive to deploy infrastructure in remote or sparsely populated regions if they can be confident of charging a higher price per customer than they could in densely populated urban areas.

Supporting comments

21. The Commission has also received letters in support of project ATLAS. In a letter of 31 October 2003, Cable and Wireless, a supplier of telecommunications and IP services, suggested that ATLAS infrastructure, although implemented in areas that are already partially served, would have an overall positive impact on telecom operators that do not hold a dominant position in the market, by providing the possibility to reach, through an open access infrastructure a larger number of business customers.
22. In a letter of 10 November 2003, SSE Telecom, a provider of telecommunication services, also argued in favour of project ATLAS. It explained that the possibility to contribute parts of existing infrastructure to the ATLAS network as well as its character of open access infrastructure eliminated any threat to existing carriers.

IV. Assessment of the measure: presence of aid

23. According to the EC Treaty and consolidated case-law there is State aid in the meaning of Article 87(1) when:
 - there is an intervention by the State or through State resources;
 - the intervention is liable to affect trade between Member States;
 - it confers an advantage on the recipient and,
 - it distorts or threatens to distort competition.

State resources

24. Scottish Enterprises is a State development agency that channels public funds for economic development purposes. Its resources, which are used to fund project ATLAS, are therefore to be considered as State resources.

Economic advantage

25. Broadband services involve three stages in production. The first is the creation of a 'passive' infrastructure which carries the data (ducts, dark fibre, access boxes), the second is data transmission by means of the 'active' infrastructure (electronic equipment) and the third is the actual services that are offered to final users (e.g. connection to the Internet). Project ATLAS will provide the first element to any interested user through the Asset Manager.
26. In principle, the tender procedure announced by the UK authorities would rule out any unnecessary advantage to the Asset Manager. However, even if the Asset Manager will not receive any unnecessary advantage, it is doubtful that the infrastructure will be built on the same terms as a private investment.
27. In addition, the Asset Manager cannot freely determine the prices, since these are set by Scottish Enterprise. These elements suggest that the prices for the dark fibre will be lower than the normal market price would have been, giving rise to an economic advantage for the telecom operators and the SP's, which can, at least partially, translate into an economic advantage for the enterprises in the business parks that are the ultimate customers of the broadband services.
28. The UK authorities have brought forward several arguments implying that the measure does not entail an advantage. First of all, they argue that the intervention is carried out at market terms and, accordingly, does not involve granting of an aid. Alternatively, even if it was not done on market terms, the State intervention provides an infrastructure that the market does not supply. It is therefore a general measure rather than an aid. Finally, the authorities argued that if there is an aid granted, it should be considered as de minimis aid. These arguments will be dealt with in the following paragraphs.

(I) intervention on market terms

29. The passive infrastructure that is provided by the ATLAS project would be 100% owned by SE, or by a 100% subsidiary of SE. The management of the assets will be carried out by an Asset Manager, which will be selected through a competitive tender. If the investment in project ATLAS was indeed carried out on market terms, it would not constitute a State aid. SE could be deemed to behave like private investors if:
 - (1) it selected the Asset Manager so to maximise revenues from the lease of the infrastructure and,
 - (2) the revenues were sufficient to repay the costs of the infrastructure within a reasonable time-horizon and provide a rate of return in line with the risk of the investment.
30. With regard to (1), it is observed that SE imposes price constraints on the manager of the infrastructure, which inevitably reduce the price obtained in the tender. As

regards (2), the complainant claims that the write off period of 25 years is longer than the life-cycle of the assets (15-20 years) and that the expected rate of return (6.9%) is lower than normally required by the market (15%). The Commission considers that the scarcity of similar projects – i.e. open access passive infrastructure – does not allow reference to a well defined market benchmark and that the overall return required by the market on integrated projects – private infrastructure plus telecom services – is likely to be greater than the return justified by an open access passive infrastructure. However, it would seem that the expected rate of return is relatively low, while certain elements of the project, in particular as regards the imposed pricing policy, are clearly outside normal market behaviour. It appears therefore difficult to conclude that the project is carried out in accordance with the Market Economy Investor Principle (MEIP).

(II) general infrastructure

31. According to the UK authorities, this type of State intervention does not fall within Article 87(1) EC but should rather be seen as a typical task of the public authority of providing infrastructure.
32. It seems that the comparison between this facility and a general infrastructure which is outside the scope of State aid control is questionable in this case. The dark fibre does not supply a service to end users, but provides an input to businesses offering broadband services. As the existence of British Telecom, THUS and other providers shows, this type of infrastructure can and is actually deployed by market operators who intend to provide the final service. Broadband services are actually offered in the concerned business parks also in the absence of State intervention, although, possibly, at a higher price. The type of service provided by the Asset Manager of the ATLAS project not only is an economically viable one, but is also targeted only at the commercial customers in the business parks and does not serve the interest of the general public. Accordingly, the Commission considers that the ATLAS project must be seen as a dedicated facility for undertakings, which is within the scope of State aid control, rather than a general infrastructure.

(III) de minimis aid

33. The UK authorities maintain that even if there is a quantifiable aid to end-users, it would be well within the amounts established by the *de minimis* Regulation 69/2001/EC.
34. The Commission considers that, while the imposed pricing policy and the open procedure to award the management of the infrastructure may avoid aid to the management company, its client telecom operators and SP's would benefit in the form of lower fees for the leasing of capacity. Competition at the wholesale level would then favour passing through the aid, at least to a certain degree, to a large number of final users. Considering that there are 13 business parks it would not be unrealistic to assume that the advantage for each individual beneficiary will fall below the *de minimis* thresholds.
35. However, the project does not envisage any mechanism to ensure pass through of the aid, nor can it be relied, at this stage, on a sufficient degree of competition at wholesale level to achieve such pass through. In addition, even if the advantage did entirely accrue to end users, the UK authorities did not provide any element on the respect of article 3(1) of the 'de minimis' regulation regarding accumulation and

monitoring. Therefore it cannot be excluded that aid granted to end users in the business parks exceeds the limits set out in the aforementioned *de minimis* Regulation.

Distortion of competition

36. The intervention of the State alters the existing equilibrium on the market by allowing entrants in the two downstream segments of telecom operations and service provision. In making their choice of investment in infrastructure, the incumbent telecom operators have based their calculation on the assumption that other operators would have had to bear the costs of a new infrastructure or pay a market price for its services, which is no longer the case after State intervention. The fact that a new infrastructure becomes available and at below market prices, has the effect of distorting competition in the downstream segments.

Effect on trade

37. Insofar as the intervention is liable to affect telecom operators and service providers from other Member States, the measures have an effect on trade. The telecom market is more and more open to competition between operators and service providers, which generally engage in activities that are subject of trade between Member States. There may also be an effect on competition between the end-users and their competitors in other Member States, although the importance of that effect will probably be relatively low.

Conclusion

38. In view of the above, the Commission considers that the project grants an economic advantage to the telecom operators and the SP's, which can, at least partially, translate into an economic advantage for the enterprises in the business parks. The project is publicly funded, distorts competition and has an effect on trade between Member States.

V. Assessment of the measure: compatibility

Introduction

39. Having established that the project involves aid within the meaning of Article 87(1) of the EC Treaty to the service provider and to the enterprises, it is necessary to consider whether the measure can be found to be compatible with the common market.
40. After having discussed at length the initial plan, the Commission was notified the new project, which considerably reduces the scope of the original intervention, adopts a simpler approach and addresses various sources of concern previously identified. The Commission considers that it has the necessary elements to take a view on the revised project.
41. The Commission notes that the project intends to ensure the widespread availability and use of high-speed broadband services at conditions closer to those in areas with a greater density of population and businesses. The Commission acknowledges furthermore that the existing frameworks and guidelines cannot be applied to assess aid measures that specifically target this objective. The Commission therefore

considers that the assessment of the compatibility of the measure with the common market needs to be based directly on Article 87(3)(c) of the EC Treaty.

42. Article 87(3)(c) of the EC Treaty states that:

“aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest” may be considered to be compatible with the common market.

Necessity of the measure

43. The e-Europe 2005 Action Plan sets out a strategy to make broadband widely available to businesses and citizens throughout the European territory at affordable prices.³ Broadband is a type of service that by its nature is capable of positively affecting the productivity of a large number of sectors and activities. In addition, the characteristics of network industries is such that services are generally available at cheaper terms where demand is higher and concentrated, i.e. in densely populated and in relatively wealthy areas. This may have the effect of increasing the disadvantage for less developed or scarcely populated areas.

44. The modified project ATLAS is aimed at lowering prices of broadband services for commercial users located in business parks. The envisaged solution is the establishment of a “passive” fibre-optics infrastructure (ducts, chambers, “dark” fibre and MMR’s), managed by an independent entity and open to all telecom operators on non-discriminatory terms.

45. The establishment of a similar infrastructure involves high fixed costs, which represent a very high proportion – typically around 80% – of the total investments needed for broadband services. This may have two consequences:

- Private operators might find it difficult to find a source of funding for similar projects – which have a long life and amortisation period – particularly in areas where demand is not very developed and coverage of cost is uncertain. This may delay the deployment or the extension of the necessary networks.
- Once an infrastructure is in place, the creation of a second network might not be economically viable. Especially if the network is controlled by a single operator this may seriously limit competition.

As a consequence, public support may accelerate the establishment of a network in the less profitable areas, while ensuring, by means of open access requirements, that competition is preserved in the future.

46. As also indicated by one of the complainants, in this particular case there might be scope for public intervention in the market for access from a node outside the business park to the immediate vicinity of the customer’s building. The existing on-park infrastructure of incumbent operators – that supports very high speed transmission data – is only partial and demand may have to be satisfied by means of creation of new infrastructure. Because of the low density of users, the costs of

³ Communication from the Commission, e-Europe 2005: An information society for all, 28.5.2002, COM(2002) 263 final.

network extension would have to be shared between just a few customers: it is likely that this translates into a higher price per customer in areas with lower density of demand.

Proportionality

47. In order for the aid measure to be compatible with Article 87(3)(c) of the EC Treaty, it must be moreover proportionate to the objective and must not distort competition to an extent contrary to the common interest. The trade-off between the advantages – in terms of a local economic development, support to information society and enhancement of competition between telecom operators and service providers – and the disadvantages – in terms of distortion of competition, possible disincentives to private investment and technological bias (the network is a glass fibre network) – has to be assessed. In this respect, the Commission notes the following positive elements:

- (1) the design and construction of the ATLAS infrastructure will be solicited from the open market in accordance with EC rules and principles on public procurement. This will minimise the cost of investment and the associated public funding;
- (2) the revised project does no longer involve the creation of a regional backhaul infrastructure, which is already provided by existing operators, but is limited to on-park infrastructure. Although some parts of the ATLAS infrastructure might overlap with that of existing operators, the incumbents might profit from the ATLAS infrastructure to provide their services in all remaining parts of the 13 business parks that they do not cover at present;
- (3) the infrastructure will be owned by Scottish Enterprise and the asset management will be outsourced to an Asset Manager following a tender procedure. This limits the potential advantage to the Asset Manager;
- (4) the project ATLAS and related activity of the Asset Manager will be confined to maintenance and lease of ‘passive’ infrastructure (ducts, chambers, “dark” fibre and MMR’s), which can support the provision of telecom services by multiple operators. The Asset Manager will not compete downstream with telecom operators and service providers;
- (5) the Asset Manager will lease capacity to whole sale operators and service providers on a transparent and non-discriminatory basis guaranteeing an open access; the pricing will be open and transparent (published on a publicly available list). The lease of passive infrastructure from an independent entity is likely to prove more effective in stimulating competition than imposing access requirement on dominant operators;
- (6) the pricing conditions are linked to the final use of capacity and afford better terms in connection to services provided to SME’s. In the case of capacity needed to serve large enterprises the prices are close to normal market rates;

- (7) the modified project ATLAS intends to utilise existing fibre telecom infrastructure wherever practicable. Existing fibre owners who already have fibre on the parks will be given the opportunity to supply dark fibre. If existing fibre is offered on appropriate commercial, technical and legal terms, ATLAS will not build duplicative infrastructure in these locations, which limits the economic impact of the project for operators that have already infrastructure in place;
 - (8) the total aid amount of aid is, although difficult to quantify, rather limited. First of all, the rate or return of 6.9% for a project which involves essentially civil engineering works, while rather low, is not entirely inappropriate. Secondly, given the size of the project and the number of enterprises concerned, the aid amount potentially reaching operators, the service providers and end-users is certainly limited.
48. In view of the above, the Commission considers that the public investment in Project ATLAS will only be provided to the extent necessary to develop the use of broadband services, particularly by SME's. This is in line with Community priorities as indicated in the e-Europe 2005 Action Plan. The intervention is designed in a way that does not distort competition to an extent contrary to the common interest.

Conclusion

49. In the light of the above, the Commission has come to the conclusion that "Project ATLAS – broadband infrastructure scheme for business parks" is compatible with Article 87(3)(c) of the EC Treaty.

VI. Decision

On the basis of the foregoing assessments, the Commission has accordingly decided that the aid involved in “Project ATLAS – broadband scheme for business parks” is compatible with Article 87(3)(c) the EC Treaty.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

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Yours faithfully,

For the Commission

Mario MONTI
Member of the Commission