



EUROPEAN COMMISSION

Brussels, 22.XI.2006

C(2006)5492 final

**Subject:**        **State Aid n° N 157/2006 - United Kingdom**  
**South Yorkshire Digital Region Broadband Project**

Madam,

## **I. PROCEDURE**

- (1) By letter registered on 9 March 2006, pursuant to Article 88 (3) of the EC Treaty, the authorities of the United Kingdom (hereafter “UK”) notified to the Commission the planned “South Yorkshire Digital Region Broadband Project” (hereafter “the Project”). By letters of 21 April 2006, 10 July 2006 and 22 September 2006, respectively, the Commission requested further information from the UK authorities. By letters of 31 May 2006, 21 August 2006 and 24 October 2006, the UK authorities responded to each of the above mentioned requests. A number of meetings between the UK authorities and the Commission took place between April and October 2006 to discuss and clarify certain aspects of the notified Project.

## **II. CONTEXT**

- (2) The South Yorkshire authorities have initiated the South Yorkshire Digital Region Broadband Project with the aim to encourage the delivery of competitive advanced broadband services in South Yorkshire.<sup>1</sup> The South Yorkshire authorities believe that the socio-economic position of the region can be improved by creating an environment that encourages businesses and individuals to use advanced electronic communications services.

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<sup>1</sup> In the present case, the UK authorities have defined advanced services for the purposes of the Project as “*high speed data services that provide symmetric data streams of greater than 10Mbps and are capable of supporting multi-user and multi-device applications*”.

The Right Hon Margaret BECKETT  
Secretary of State for Foreign and Commonwealth Affairs  
Downing Street  
London SW1A 2AL  
United Kingdom

- (3) The UK authorities are in the process of procuring, through a public tender, the construction, maintenance and operation of an advanced infrastructure which will use existing infrastructure, supplemented by newly built ones. Since the Project will require a number of public sector entities in the region to work together with suppliers, a Special Purpose Vehicle (“SPV”) owned by the local authorities will be created to ensure the proper governance and financial management of the Project. In broad terms, the planned network would be used (i) to meet the internal networking needs of a wide range of public sector organisations<sup>2</sup>, and (ii) to provide an open and non-discriminatory access to service providers to enable them to supply a multiple of high-speed and bandwidth hungry applications such as High Definition Television (HDTV), voice (VoIP) and PC-based services (including government services) to citizens and SMEs.
- (4) Like other regions within the European Union which were dependent on heavy industries, such as coal and steel, South Yorkshire has gone through a period of economic readjustment in the past years. In 2000, South Yorkshire was designated an Objective 1 area under the European Regional Development Fund (ERDF) rules because of the economic challenges facing the region. South Yorkshire is also an assisted area under Article 87(3)(a) of the EC Treaty.<sup>3</sup>
- (5) As a consequence of its socio-economic profile, South Yorkshire offers telecommunications companies a limited incentive to invest in an advanced<sup>4</sup> broadband network outside a few affluent localities<sup>5</sup>. In particular, from the 54 exchanges available to operators in South Yorkshire, it appears that, according to the UK authorities, less than half could be upgraded to ADSL2+.<sup>6</sup> Were this to happen, only a minority of the business and residential users would be able to receive advanced broadband services. In fact, a significant part of businesses (41%) and homes (45%) lies outside the geographical reach of exchanges capable of supporting advanced broadband services. The situation would be worst for non-privileged areas since the economic and social benefits of advanced broadband are, according to the UK authorities, expected to be greater than those derived from the move from narrowband dial-up to first generation broadband services. Accordingly, without public intervention, the authorities believe that, as with the roll-out of first generation broadband services, the region

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<sup>2</sup> According to the UK authorities, excluding central government departments and agencies, there are approximately 1000 major public sector sites within South Yorkshire that either require or would significantly benefit from secure high speed data connectivity.

<sup>3</sup> Unemployment, GDP per capita, average earnings, educational attainment and workforce participation in the region as a whole is below the UK average.

<sup>4</sup> This conclusion was based on a prior market research and numerous contacts and correspondence between the South Yorkshire authorities and network operators in the region.

<sup>5</sup> The South Yorkshire authorities expect that between 12 and 18 exchanges of currently 54 in South Yorkshire would be likely to produce a sufficient return on investment for commercial telecom operators.

<sup>6</sup> ADSL2+ is the next generation of broadband technology for provision of broadband services over a copper phone line, and an upgrade in comparison to existing ADSL broadband services. ADSL2+ enables faster download speeds – theoretically up to 20Mb – over the copper phone line, although these speeds will normally only be possible for users who live in a radius of less than 2 km from the exchange.

would have to wait up to 5 years to reap the economic and social rewards initially gained elsewhere in the UK where advanced broadband networks will be readily available. Such an outcome would further cement South Yorkshire's position as the most deprived region in the country.

- (6) Given the lack of commercial incentives for private telecommunication providers to construct an infrastructure capable of providing high-speed broadband services in the region, the Southern Yorkshire authorities decided to launch the notified Project.

### III. DESCRIPTION OF THE MEASURE

- (7) *Objectives:* The primary objective of the Project is to facilitate the economic transformation of South Yorkshire by creating a ubiquitous high speed infrastructure enabling the delivery of a range of advanced broadband services to the public sector, local businesses and residents. In particular, the Project aims (i) to improve the existing public sector broadband network in the region, (ii) to make advanced broadband access available to SMEs across the region to compensate for their regional handicaps and thus improve their competitiveness in the global marketplace, and (iii) to take advanced broadband to the socially excluded to enable them to develop their skills and equip them with the tools necessary to participate in the modern marketplace.
- (8) *Legal basis:* The measure is based on the Local Government Act 2000.<sup>7</sup>
- (9) *Target areas:* The Project is aimed at South Yorkshire, generally, and more specifically at the four areas that make up South Yorkshire, that is Barnsley, Doncaster, Rotherham and Sheffield.
- (10) *Operational aspects:* A "Technology Partner" will be selected to build, manage and operate the network. While the SPV retains the right to exploit and market the network to the public sector for a period of ten years - at the end of which the Technology Partner will have the full right to commercially exploit the network – it is expected that either the SPV itself or most likely the Technology Partner will also market the network to service providers. In that regard, third party access to the network will be mandated on an open and non-discriminatory basis. The Project provides that the open access obligation may continue being in force after the expiry of the above-mentioned 10-year-period.
- (11) *Procurement:* The selection of the Technology Partner will be conducted through an open, transparent and non-discriminatory tender procedure in accordance with EU procurement rules and on the basis of the most economically attractive tender submission in order to ensure that the commercial terms upon which the Technology

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<sup>7</sup> <http://www.opsi.gov.uk/acts/acts2000/20000022.htm>

Partner will be appointed will reflect the market rate and will not result in any advantage being conferred.

- (12) *Claw back mechanism:* The Project will also provide for a clawback mechanism to recover excess profits from the Technology Partner. Although subject to final negotiations, the principle will be that once the initial capital and operational costs of the Project to the Technology Partner (plus an agreed percentage) have been recovered through public investment and revenues flowing from service providers, any subsequent margin accrued by the Technology Partner as result of increased uptake will be subject to the clawback mechanism at an agreed percentage rate.
- (13) *Technology:* Although the exact nature of the infrastructure to be built is not yet determined, prospective technology partners will have to comply with the principle of technological neutrality and satisfy a number of parameters inherent to the operation of a advanced broadband infrastructure. In particular, the advanced broadband infrastructure should, amongst other, allow (i) the management of network capacity using virtual private networks (VPN, an essential feature on a shared platform), (ii) the capability to manage contention when network capacity is in demand (Quality of Service), (iii) appropriate levels of resilience, (iv) security and authentication, and (v) facilities to support the transmission of television signals.<sup>8</sup>
- (14) The Project does not define precise upload and download speeds on the ground that advances in hardware and software technology will allow multiple services to be delivered simultaneously. Consequently, the upload and download speeds will depend upon the mix of services consumed by a given user at any one time rather than the speed of the copper path itself. It is expected that most residential users will consume a multiple play of HDTV, Internet access and telephony services, which in practice will require about 10 – 50 Mbps download, and 1 - 20 Mbps upload. Usage patterns will however evolve over time, since different users will consume different services. The Project expects to see a shift toward increased upload speeds as newer collaborative applications emerge from the market. For business users, the upload/download speed will be a function of

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<sup>8</sup> The UK authorities expect that the network to be financed will include initially the deployment of ADSL2+, VDSL (Very-high digital subscriber line), VDSL2 and possibly, in some new residential zones and regeneration schemes, fibre to the home (FTTH). According to the UK authorities, it is likely that the initial roll out of VDSL2 will be to those areas that are not currently served with ADSL2+ (including those areas geographically remote from exchanges where exchange-based ADSL2/2+ cannot deliver sufficient bandwidth to support initial advanced broadband service provision). The first stage of deployment of the Project to the remaining areas will most likely be based on existing ADSL2/ADSL2+ infrastructure whereby the successful bidder would have to take all necessary measures to ensure that such infrastructure is also upgraded in order to support the required functions of an advanced broadband network as defined by the Project, functions that are not currently built into the existing ADSL2+ infrastructure (i.e., provision of VPN, quality of services etc.). However, there will be a mandate on the Technology Partner to migrate *all* areas to VDSL2 once the roll out of VDSL2 to the more remote areas is complete. In addition, it is likely that Digital Region will also offer FTTH for social housing under renewal and redevelopment projects. At most, the Project would provide FTTH to an initial 10% of homes in some of the most economically and socially challenged parts of South Yorkshire. In any event, whatever the technology chosen, the network to be built should be upgradeable and scalable to meet the expected incremental shift towards higher speeds and larger bandwidths.

the choice of advanced broadband services they procure from service providers, although the business market will undoubtedly require more symmetric services from an early stage. According to the UK authorities, the services to be offered by the Digital Region Project are therefore clearly differentiated from existing 'entry level' ADSL or ADSL2/2+ services.

- (15) *Safeguards to limit the impact on existing operators:* According to the UK authorities, the technical specification contained in the invitation to tender seeks to ensure that services offered on the Digital Region platform do not substitute any existing ADSL services and the currently very limited ADSL2+ provision in the region, nor any likely, albeit limited, future provision of ADSL2+ in some areas. In particular, the tender specification requires potential Technology Partners to ensure differentiation from ADSL2+ on two essential aspects: (i) an ability to support multiple, high bandwidth services, such as HDTV, video and voice and (ii) an ability to manage quality of service, multiple VLANs and guaranteed bandwidth to the end user on behalf of retail Service Providers. The UK authorities consider that neither of these two fundamental network characteristics is available on current ADSL2/2+ services delivered by existing operators, nor is the market indicating that South Yorkshire is likely to receive any advanced broadband infrastructure incorporating these features in the near future<sup>9</sup>. Accordingly, these high bandwidth and service management attributes (which together define an advanced broadband infrastructure) ensure, according to the UK authorities, that the services provided by the Project will not be substitutable with existing and any likely future ADSL2/2+ provision.
- (16) With regard to the supply of leased lines<sup>10</sup>, the UK authorities considered that any distortion of competition will be minimal for the following reasons.
- (17) First, with reference to point to point links across South Yorkshire, most point to point services are based on Ethernet LAN extension products delivered by the "fibre to the business" segment of the market (typically 10Mb to 1Gb). The Project will not be offering wholesale fibre access to the premise in this manner. Thus, service providers using the wholesale access will not be in a position to offer a retail equivalent for such services. Moreover, the actual market for such point to point connectivity within South Yorkshire is judged to be very small. Second, with regards to corporate private networks, their topology is such that service providers to corporate organisations interconnect access circuits into their own point of

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<sup>9</sup> According to the UK authorities, any likely offers of ADSL2+ in the Region will be limited. Were ADSL2+ via local loop unbundling to become available in South Yorkshire, still a majority of business (41%) and homes (45%) will fall outside the reach of bandwidth capable of supporting such advanced services.

<sup>10</sup> The UK authorities define a (business ) leased line as an uncontended (that is, not shared) channel of defined bandwidth dedicated to the sole use of the end user. A leased line may thus function in three ways: (i) as a point to point link between two sites, (ii) as a means of interconnecting into point of presence as part of a wider national or international corporate private network, and (iii) as an uncontended means of gaining internet access.

presence on their own national/international network. These access circuits are invariably high speed fibre Ethernet LAN extension circuits. As described above, the Project will not have a fibre to the building network available for Service Providers to use outside residential areas. In addition, Digital Region, as a sub regional broadband network, is unlikely to interconnect with the networks of new market entrants unless they have a mass market retail broadband proposition. Given that most, if not all, of these carriers deliberately avoid the mass retail market as a commercial strategy, there is little incentive for them to pay for the cost of interconnection. Accordingly, the Project does not expect to see corporate Service Providers as either wanting to invest in creating an interconnection with Digital Region or redefining their operational support systems to access a relatively small corporate market in South Yorkshire.

- (18) With reference to the uncontended leased lines used for internet access, the UK authorities admit that it would be possible for service providers to procure wholesale connectivity to deliver such a retail offering to businesses that have a heavy demand for high uncontended internet access (as distinct from higher speed broadband contended –that is shared - internet access). This however could only apply to a small subset of businesses that require lower uncontended bandwidth that can be delivered over copper (businesses that require high speed internet access, typically in excess of 10Mbps uncontended, will require fibre connectivity, which as mentioned above, is beyond the scope of the Project). More particularly, the UK authorities consider that this market is relatively small compared to London/Leeds/Manchester (around [...] <sup>11</sup> undertakings currently using uncontended leased lines for internet access in the whole of South Yorkshire).<sup>12</sup> Regardless of whether such an estimated small sub-segment of the overall leased lines market could be affected by the Project, the wholesale price of bandwidth to service providers wishing to subsequently retail any uncontended leased line internet access circuits will be benchmarked against comparable cities elsewhere in the UK and EU.
- (19) Finally, with regard to existing cable infrastructure, the UK authorities point to the limited footprint of cable in the region ([...] <sup>13</sup> of households) and the fact that the existing cable infrastructure is not (or is not either expected to be) upgraded and is, according to the UK authorities, mostly limited to analogue TV services.
- (20) *Beneficiaries:* The direct recipient of the aid will be the selected Technology Partner. Indirect beneficiaries will be the service providers and public sector, business and residential end users in South Yorkshire. The business end-users are expected to be mainly

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<sup>11</sup> Covered by the obligation of professional secrecy.

<sup>12</sup> According to the UK authorities, leased lines operators only use [...] \* exchanges. \*(covered by the obligation of professional secrecy).

<sup>13</sup> Covered by the obligation of professional secrecy.

SMEs as large undertakings are served by dedicated point-to-point networks.

- (21) *Budget and aid intensity:* Both the final budget as well as the aid intensity will depend on the outcome of the procurement process. Even though the capital cost of the Project will depend on the technology employed and the scope and coverage of the network, it is expected that the capital and revenue cost of the Project over its life will be approximately £[...] <sup>14</sup> million at current values and that the public sector input will be approximately £[...] <sup>15</sup> million. <sup>16</sup> Approximately, this would give an aid intensity of up to [...] <sup>17</sup>%.
- (22) However, according to the UK authorities, this does not include the effects of taxation nor take into account the actual timing of payments which will not all be made in the first year of the Project, nor that the public sector funding is intended to be repaid during the life of the Project. In particular, the initial public sector investment will be used to fund the capital investment and early operating costs until revenues from service providers begin to flow back to the SPV. The business model of the Project provides that revenues will flow from the end-user to the service provider (in the form of payment for services - Internet Access, TV, etc), then to the Technology Partner (in the form of charges for access to the advanced broadband service) and finally to the SPV (in the form of return of the capital grant together with any "clawback" payments).
- (23) *Eligible costs:* The eligible costs are the capital costs of constructing the necessary infrastructure. The Project will restrict its activities to the creation of an advanced broadband infrastructure to which wholesale access will be granted to service providers.
- (24) *Funding instrument:* Public funds will be paid to the selected Technology Partner in the form of a service grant.
- (25) *Duration of the measure:* The duration of the Broadband Project is set at a maximum of ten years, although it is believed that the vast majority of the costs will be incurred in the first three years of the Project.
- (26) *Product or service markets affected:* The selected Technology Partner will build a network for high speed broadband internet. The infrastructure will be made available to service providers at a wholesale price. The wholesale broadband access market, as defined in the Commission Recommendation on relevant markets <sup>18</sup> for

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<sup>14</sup> Covered by the obligation of professional secrecy.

<sup>15</sup> Covered by the obligation of professional secrecy.

<sup>16</sup> A part of this amount will be made up by funds from the European Regional Development Fund ("ERDF") and the rest from the local authorities.

<sup>17</sup> Covered by the obligation of professional secrecy.

<sup>18</sup> Commission Recommendation 2003/311/EC of 11 February 2003 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC.

electronic communications services is directly affected by the measure as is the non-regulated retail broadband market (including cable).

- (27) *Monitoring*: The main means of monitoring the Broadband Project is a Special Purpose Vehicle (“SPV”), owned by the South Yorkshire authorities. As stated above, the SPV is created to market the infrastructure created by the Project to public sector users and service providers. The SPV will also be responsible for appointing a Technology Partner, providing advice and expertise and managing the funding streams.

#### **IV. STATE AID ASSESSMENT OF THE MEASURE**

- (28) According to the EC Treaty and consolidated case-law there is State aid within the meaning of Article 87(1) when:

- there is an intervention by the State or through State resources;
- it confers an economic advantage on the recipient;
- it distorts or threatens to distort competition;
- the intervention is liable to affect trade between Member States;

##### State resources

- (29) The measure is partly financed with European structural funds, which qualify as state resources once they come under the control of a Member State, and partly by resources of the South Yorkshire authorities. Hence, state resources are involved.

##### Economic advantage

- (30) *Technology Partner*: Through the tender process the successful bidder will receive financial support which will enable it to enter the market, build an advanced broadband infrastructure and provide wholesale broadband access services on conditions not otherwise available on the market.
- (31) Although an open tender procedure tends to reduce the potential advantage in terms of excessive profits, the Technology Partner would be able to offer access services at lower prices and thus attract more customers than under normal conditions. The Project therefore confers an economic advantage to the Technology Partner.
- (32) *Third party operators*: The Project will enable service providers to provide advanced broadband services to end users at prices that will not otherwise have been available under normal market conditions. Moreover, in most areas covered by the notified measure, there is no such broadband infrastructure and therefore no comparable



broadband wholesale offer at all, preventing market entry of third parties such as service providers without own infrastructure. Therefore, third party providers of broadband services using wholesale connectivity built under the measure might also receive an economic advantage.

- (33) *End users*: The ultimate objective of the measure is to provide affordable advanced services to residential and business users at conditions which are currently not available in the target areas. Whereas residential users are not subject to State aid rules, businesses in the targeted geography will benefit from service coverage beyond and prices below what would be provided on a purely commercial basis.

### Distortion of competition

- (34) The intervention by the South Yorkshire authorities alters the existing market conditions by allowing the provision of advanced broadband services by the Technology Partner at the wholesale level, and by the service providers at the retail level.<sup>19</sup> It cannot be excluded that a number of operators might have decided to enter the market by having recourse to more expensive market-based solutions. Therefore, the fact that a new broadband service becomes available at a lower price than existing, albeit expensive, solutions has the effect of distorting competition for advanced broadband services.
- (35) Moreover, the fact that a new infrastructure and wholesale services become available and *prima facie* below market prices has the effect of distorting competition also in downstream markets. Business users or SMEs may subscribe to advanced broadband services provided by service providers using the Technology Partner's infrastructure instead of more expensive market-based solutions. Therefore, there is also a potential distortion of competition at the retail level.
- (36) The scheme is also selective in that it is addressed to undertakings active only in certain markets for electronic communications services (wholesale and retail broadband services). These selectivity elements also induce a potential distortion of competition<sup>20</sup>.

### Effect on trade

- (37) Insofar as the intervention is liable to affect service providers from other Member States, the measure has an effect on trade. The markets for electronic communications services are open to competition

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<sup>19</sup> Although the SPV will not provide services at the retail level, the Technology Partner may do so; however, it will have to use another (affiliated) entity, clearly separated from the wholesale business carried out by the Technology Partner. The SPV will ensure that the affiliated retail activities of the Technology Partner are treated in the same way as any other third party having access to the newly built infrastructure; see below, paragraph 51.

<sup>20</sup> Case C-143/99 *Adria Wien Pipeline* 2001 [ECR] I-8365.

between operators and service providers, which generally engage in activities that are subject to trade between Member States.

## Conclusion

- (38) In view of the above, the Commission considers that the notified measure grants an economic advantage to the selected Technology Partner, service providers and final users that exercise an economic activity. The measure is publicly funded, distorts competition and has - at least as far as the Technology Partner and the other service providers are concerned - an effect on trade between Member States. Therefore the Commission regards the notified measure as constituting State aid within the meaning of Article 87 (1) of the EC Treaty.
- (39) Having established that the Project involves State aid within the meaning of Article 87(1) of the EC Treaty, it is necessary to consider whether the measure can be found to be compatible with the common market.

## **V. COMPATIBILITY ASSESSMENT**

- (40) The Commission notes that the Project aims to ensure the availability of an open, carrier-neutral, advanced wholesale broadband infrastructure in South Yorkshire and, as such, does not fall under one of the existing frameworks and guidelines. It should be noted that the areas covered by the Project are located within areas eligible under the European Regional Development Fund, as well as Art. 87 (3) (a) assisted areas within the meaning of the Regional Aid Guidelines.<sup>21</sup> However, while the aid to be granted under the notified Project may in some cases qualify as aid for initial investment within the meaning of those guidelines insofar as it benefits the Technology Partner, the same cannot be said in respect of its impact on the third party operators and end users, for whom the benefit is not linked to any initial investment. Moreover, the focus of the measure is to promote broadband and not regional development as such.
- (41) 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<sup>22</sup> which states that:

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<sup>21</sup> OJ 1998 C 74, p.9.

<sup>22</sup> See also, similar decisions for other regions of the UK: N 126/04 "*Broadband for SMEs in Lincolnshire*", 14.12.2004, N 199/04 "*Broadband business fund*", 16.11.2004, and N 307/04 "*Broadband in Scotland – remote and rural areas*" of 16.11.2004, at [http://europa.eu.int/comm/secretariat\\_general/sgb/state\\_aids/](http://europa.eu.int/comm/secretariat_general/sgb/state_aids/).

*“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.

- (42) The UK authorities submit that, if the Commission were to find that the measure constitutes aid, this aid would be compatible with the common market under Article 87 (3)(c) of the EC Treaty.
- (43) In order to be compatible under article 87(3)(c) an aid must pursue an objective of common interest in a necessary and proportionate way. In particular, the measure shall be assessed with respect to the following questions:
- (1) Is the aid measure aimed at a well-defined objective of common interest (i.e. does the proposed aid address a market failure or other objective)?
- (2) Is the aid well designed to deliver the objective of common interest? In particular:
- (a) Is the aid measure an appropriate instrument, i.e. are there other, better-placed instruments?
- (b) Is there an incentive effect, i.e. does the aid change the behaviour of firms?
- (c) Is the aid measure proportional, i.e. could the same change in behaviour be obtained with less aid?
- (3) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

## **1. The support of broadband rollout is in line with the common interest**

### *Community policy*

- (44) As outlined in its Communication “i2010 – A European Information Society for growth and employment”<sup>23</sup>, the Commission actively supports the widespread availability of broadband services. There is clear evidence for the regional economic development benefits resulting from more widespread broadband deployment, including job creation and retention as well as improved health and education services<sup>24</sup>. In order to achieve better broadband coverage and take-up, the Commission encourages Member States to put comprehensive

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<sup>23</sup> COM(2005)229 final, 1 June 2005.

<sup>24</sup> For an overview, see: Lehr, Osorio, Gillet and Sirbu (2005): “Measuring Broadband’s Economic Impact”, and Orazem, Peter, University of Kansas Business School (2005), “The Impact of High-Speed Internet Access on Local Economic Growth”.

national broadband strategies in place.<sup>25</sup> The notified Project helps to provide access to advanced to business and residential end users in a disadvantaged area of the United Kingdom. It is therefore in line with the common interest.

### ***Cohesion objective and market failure considerations***

- (45) Lack of broadband coverage is due, among others, to some of the typical economic problems associated with networks industries. In particular, due to economics of density, broadband networks are generally more profitable to roll out where potential demand is higher and more concentrated. Because of high fixed costs, unit costs escalate dramatically as population densities drop. As mentioned above, due to the socio economic profile of South Yorkshire, only 50% of the population can have access to an advanced broadband infrastructure (ADSL2). As a result, in rural areas where demand is not developed and coverage of network cost is uncertain, private network operators have so far decided not to provide such broadband infrastructure nor *a fortiori* invest in advanced broadband infrastructure. In addition, in the urban areas of South Yorkshire where ADSL2 does exist, it appears that it is also unlikely that the existing infrastructure owners will invest further to provide advanced broadband services to the detriment of the local SMEs which are thus deprived of the required broadband connectivity that is necessary in today's competitive marketplace.
- (46) Hence, by funding the establishment of a new advanced broadband infrastructure in South Yorkshire, an area eligible under Objective 1 of the European Regional Development Fund, the UK authorities pursue genuine cohesion<sup>26</sup> and economic development objectives which will allow competitive entry by service providers. This will have a positive impact on supply and competition in the geographic areas covered by the measure to the benefit of citizens and businesses.

## **2. Well-designed aid**

### ***(a) Aid is the appropriate instrument***

- (47) Although, as regards the supply side, it could be argued that tariff and access regulation imposed by the UK regulator could be another instrument of state intervention, the fact remains that *ex ante* regulation, although necessary, is not a sufficient instrument to enable the supply of broadband services in remote and underserved regions. In particular, *ex ante regulation* presupposes the very existence of an advanced broadband access infrastructure, the absence of which is at the heart of the notified measure. Likewise, in areas where basic

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<sup>25</sup> Commission Communication COM(2004) 369 of 12.05.2004, "Connecting Europe at High Speed – National Broadband Strategies".

<sup>26</sup> It is envisaged that the measure may be supported by EU structural funds.

broadband infrastructure already exists, alternative operators that rely on BT's (the incumbent fixed operators in the UK including South Yorkshire) wholesale access products (bitstream) cannot offer advanced broadband services unless BT decides one day to upgrade its existing broadband infrastructure.

- (48) Demand-side measures in favour of broadband (such as vouchers or tax advantages) could be another instrument. However, these measures do not solve the illustrated problems on the supply side.
- (49) In view of the market situation in South Yorkshire, the Commission concludes that, in this specific context, the development of a wholesale, open access, advanced broadband network with public support is an appropriate instrument to achieve the set objectives.

***(b) The aid provides the right incentives to operators***

- (50) The financing by the South Yorkshire authorities provides a significant and direct investment incentive for the chosen Technology Partner to roll out an advanced broadband access infrastructure throughout the entire region. According to the UK authorities, the South Yorkshire authorities have received a number of bids for the Technology Partner contract (although no final decision has been taken pending the Commission's decision under the State aid rules) and several network operators and service providers have already expressed an interest in using the wholesale access to provide advanced services to end users. In particular, there is consensus among operators that the notified Project offers a realistic proposition to overcome the difficulties faced by the limited wholesale offer of BT in the region and the absence of any advanced networks in rural and underserved parts of South Yorkshire. Therefore, it is expected that the project also stimulates competition between broadband providers in the area.

***(c) Proportionality***

- (51) The South Yorkshire authorities have designed the notified Project in a way that minimises the State aid involved and potential distortions of competition arising from the measure. In this respect, the Commission notes, *inter alia*, the following positive elements in the overall design of the measure:
- *Open tender:* The South Yorkshire authorities will select the Technology Partner for the construction of an advanced broadband infrastructure on the basis of an open, transparent and non-discriminatory tender procedure based on the EU public procurement rules. The tender, seeking the economically most advantageous proposal, will be designed to minimise the cost of investment and the

associated public funding, using where available any existing infrastructure<sup>27</sup>, whilst still ensuring an appropriate level of service.

- *Wholesale access:* The Technology Partner will provide open, wholesale access to the newly built infrastructure to service providers on a transparent and non-discriminatory basis. To avoid any kind of unfair competition, the SPV will also monitor whether any retail operations by the Technology Partner also comply with the principle of equivalence<sup>28</sup>. Overall, the wholesale third party access obligation is expected to lead to increased competition at the retail level both as regards the services to be offered and the prices charged.
- *Minimizing effects on existing infrastructure providers and operators:* The Technology Partner will have to use any existing infrastructure, whether owned or leased, thus avoiding the unnecessary duplication of existing infrastructure and minimizing the overall costs of the Project. The Project does not either impact on existing ADSL services. Demand substitutability between ADSL and advanced broadband services appears to be low.<sup>29</sup> To support advanced broadband services the infrastructure to be built should guarantee (i) end-to-end quality of service across the network (ii) VPN functionality with the ability to deliver multiple differentiated services, and (iii), sufficient bandwidth to support such multiple services. These requirements are not fulfilled by existing ADSL (wholesale) services.
- With regard to leased lines to businesses, the Project will not offer point to point connectivity between sites nor fibre to the building. Therefore, there is no overlap with existing leased lines offers of this kind to businesses. With regard to uncontended leased lines used for Internet access only, although a certain degree of substitutability with the foreseen advanced broadband services may exist, it appears that the overall size of this market is relatively small [...] <sup>30</sup>. In addition, as the UK authorities have stressed, the wholesale price of bandwidth to service providers wishing to subsequently retail any uncontended leased line internet access circuits to such clients will be benchmarked against comparable cities of the UK and the EU, thus minimizing any likely distortion of competition.
- Finally, as regards existing cable services, these are currently limited both in terms of footprint (around [...] <sup>31</sup> of the residential market)

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<sup>27</sup> A successful bidder would either have to use its own (if any) infrastructure or the one built by other operators through local loop unbundling.

<sup>28</sup> The SPV retains the contractual right of intervention should the Technology Partner fail to comply with the principle of equivalence, a principle that will abide the Technology Partner in case an affiliated entity also uses the network thus built to provide advanced broadband services at the retail level.

<sup>29</sup> Many of the services that will be offered by the infrastructure created under the Project (i.e., HDTV, video services, etc.) cannot be delivered via the existing BT IPstream wholesale platform or via ADSL, ADSL2+ or cable.

<sup>30</sup> Covered by the obligation of professional secrecy.

<sup>31</sup> Covered by the obligation of professional secrecy.

and nature (mainly analogue television services). Cable networks in the region are not upgraded to provide advanced broadband services and as the UK authorities pointed out, are not expected to be so in the near future. As regards the business sector, given the topology of the existing cable network in South Yorkshire, approximately only 25% of businesses can theoretically receive cable modem services although none receives any such services to date. Accordingly, any likely distortion of competition vis-à-vis existing or potential cable services will be limited.

- *Technological neutrality*: The measure is technologically neutral, i.e., it does not favour a priori any given technology. Although it is highly unlikely that the successful Technology Partner will deploy wireless technologies, the latter being in most cases unsuitable for the provision of advanced broadband services, it will be for the participating bidders to decide which technology to deploy. The main feature of the Project is that whatever the technology to be used, the infrastructure chosen should be scalable and upgradeable to meet future requirements for higher speeds and more bandwidth.
- *Clawback mechanism*: According to the UK authorities, a clawback mechanism for the Project will ensure that the Technology Partner is not making excessive returns. This mechanism will help to reduce the aid amount involved in the measure.

### **3. The distortions of competition and the effect on trade are limited and the overall impact of the measure is positive**

- (52) The Commission concludes that the notified measure will offset a geographical and commercial handicap in a significant part of South Yorkshire and can promote the competitive supply of high-speed broadband services across the whole of South Yorkshire. In view of the design of the measure, and given the specific characteristics of the South Yorkshire broadband access market, the overall impact on competition is deemed to be positive. On the effect on trade, the Commission does not identify negative spill-over effects for other Member States.
- (53) On balance, the Commission concludes that the overall effect of the measure is deemed to be positive. The measure is clearly in line with the objectives of Article 87 (3) (c) EC Treaty as it facilitates the development of certain economic activities (wholesale and, indirectly, retail broadband services) in certain remote and rural areas. The intervention is designed in a way that does not distort competition or affect trading conditions to an extent contrary to the common interest.

### **Conclusion**

- (54) In the light of the above, the Commission has come to the conclusion that the aid involved in the notified measure is compatible with Article 87(3)(c) of the EC Treaty.

## VI. DECISION

On the basis of the foregoing assessment, the Commission has accordingly decided that any aid contained in the South Yorkshire Digital Region Broadband Project is compatible with Article 87(3)(c) of the EC Treaty.

The Commission reminds the UK authorities that any modification of the notified measure has to be submitted to the Commission.

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://ec.europa.eu/community\\_law/state\\_aids/index.htm](http://ec.europa.eu/community_law/state_aids/index.htm).

Your request should be sent by registered letter or fax to:

European Commission  
Directorate-General for Competition  
State Aid Greffe  
Rue de Spa 3  
B-1049 Brussels  
Fax No: +32 2 2961242

Yours faithfully,  
For the Commission

*Neelie KROES*  
Member of the Commission