



EUROPEAN COMMISSION

Brussels, 12.05.2010
C(2010)3204

Subject: **State aid N 461/2009 – United Kingdom**
 Cornwall & Isles of Scilly Next Generation Broadband

Sir,

I. SUMMARY

- (1) I am pleased to be able to inform you that the European Commission has assessed the measure "*Cornwall & Isles of Scilly Next Generation Broadband*" (hereafter: "the measure") and decided not to raise objections as the State aid contained therein is compatible with Article 107(3)(c) of the TFEU¹.

II. PROCEDURE

- (2) Following pre-notification discussions, by letter dated 29/07/2009 pursuant to Article 108 (3) of the TFEU, the United Kingdom ("UK") authorities notified a measure to the Commission for supporting the deployment of next generation broadband networks in the Cornwall region. Further submission was received on 28/09/2009.
- (3) By letter registered on 21/10/2009, Vtesse Ltd., a UK broadband operator, lodged a complaint with the Commission regarding the notified measure. The complaint, together with the additional information requested by the Commission on the measure, was sent to the UK authorities on 23/10/2009. By letter registered on 09/11/2009 the complainant submitted additional information, which was forwarded to the UK authorities on 19/11/2009. Further information was submitted by the complainant by letter registered on 16/03/2010.

¹ With effect from 1 December 2009 Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the TFEU. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

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- (4) The UK authorities provided answers to the Commission's request of information and their comments on the complaint by letters dated 23/11/2009 and 04/12/2009. The Commission requested the clarification of additional information from the UK authorities by letter dated 28/01/2010, for which they provided answer by letter dated 03/03/2010.

III. CONTEXT

III.1. The region of Cornwall and the Isles of Scilly

- (5) Cornwall and the Isles of Scilly (hereafter: "Cornwall region") is located in the South West Peninsula of the United Kingdom. The region has a population of 529,500 living in small towns and dispersed rural communities and a small archipelago of islands (the Isles of Scilly) located 26 miles off the far west of the county. The Cornwall region is the only region in England that has qualified for convergence funding, the highest level of EU funding for the worst performing economies, for the period 2007-2013. Despite recent improvements in many key areas, partly as a result of the 2000-2006 Objective One programme, the region's economy still lags the UK and EU averages. For example, the GVA figures² for Cornwall and the Isles of Scilly were 63% of UK average (2006) and average earnings were 79% of UK average (2008).

III.2. The National Broadband Strategy

- (6) On 16 June 2009, the UK Government published the Digital Britain Report³, its strategic vision for ensuring that the UK is at the leading edge of the global digital economy. *Inter alia*, the National Broadband Strategy aims to achieve the following objectives: (1) ensure universal broadband coverage of 2 Mbps to all by 2012 (2) 90% of Next Generation Broadband coverage by 2017. The UK authorities acknowledge that to achieve these ambitious objectives, well targeted state aid measures would also be necessary.
- (7) According to the Digital Britain Report, Next Generation Broadband will be delivered to between half and two-thirds of the UK population without Government intervention by 2017. It is highly likely that the Cornwall region falls into the remaining one-third of the UK population that would require Government intervention.

III.3. Rationale for public intervention

Existing networks are not sufficient to satisfy the continuously growing needs of citizens and business users in the area in question

- (8) In terms of Information and Communications Technology (ICT), the Cornwall region used EU funding to deliver a successful broadband programme (actnow⁴) which has been a catalyst for significant economic growth. It is calculated that the

² Gross Value Added (GVA) is a measure in economics of the value of goods and services produced in an area, industry or sector of an economy.

³ Available at: <http://www.culture.gov.uk/images/publications/digitalbritain-finalreport-jun09.pdf>.

⁴ The original actnow project was launched in 2001 and consisted of infrastructure and business support. In the absence of any State aid broadband guidelines, the aid was approved under the Regional Aid Guidelines (approved on 6/12/2001, project reference number: DC/THM/1102/6).

£20 million actnow programme has generated an annual GDP impact exceeding £100 million.

- (9) However, the Cornwall region's current broadband infrastructure is based upon technology which physically limits the speed, flexibility and quality of connections and ultimately limits the potential for further economic growth. For instance, in terms of adsl networks, 68% of telephone lines having lengths of over 1km⁵, the vast majority of lines are unable to sustain high speed ADSL connections anywhere close to the advertised 'up to 8Mbps' used by virtually all service providers.
- (10) Lack of adequate broadband connections can hamper business activity. A survey of the region showed that the internet is critical for 87% of businesses and 32.5% of the respondents stated that the speed of their internet connection limited the effectiveness their business could make of the internet, and a similar percentage stated that connection reliability had a similar effect⁶. Furthermore, a number of case studies of businesses have been prepared⁷ to illustrate a need for improved speed, reliability and quality of service for applications such as video conferencing, remote access to systems, flexible working and manipulation and transfer of video files.

Commercial operators do not have sufficient commercial incentives to upgrade the existing networks

- (11) Currently the region of Cornwall has a basic broadband availability of around 99%⁸. 22% of the exchanges⁹ are currently unbundled (compared with 34% across the UK) with 6 active LLU operators¹⁰. However, none of the operators – including the incumbent, BT – have plans to upgrade the existing basic broadband network to an NGA infrastructure in Cornwall¹¹. Cable networks cover only 3% of the population operated by Virgin, which will be upgraded¹² - and according to the UK authorities this will be the only territory where NGA network will be available on commercial terms in this region in the near future.
- (12) The UK authorities also argue that historical pattern of the investments made by the existing network investors over the last years in upgrading their broadband infrastructures to provide higher speeds in response to users' demands is not deemed satisfactory. With the exception of patchy 3G mobile services, the

⁵ Due to technological reasons, the available bandwidth via copper network using ADSL technology is significantly deteriorating as the distance between the exchange and the end users sites increase.

⁶ See at: <http://www.actnowcornwall.co.uk/documents/Cornwall-Business-Broadband-Survey.doc>.

⁷ See at: www.actnowcornwall.co.uk/NGBCaseStudies.asp.

⁸ According to the UK authorities, 1-2% of current adsl lines are not able to provide a basic 512 kbps broadband connection due to, for instance, the length of the line.

⁹ Exchange is defined as the geographic area within which sites are connected via the local loop (i.e. telephone cables that run to home and business).

¹⁰ Local loop unbundling: it allows telecommunications operators to use connections of other operators from the telephone exchange's central office to the customer's premises.

¹¹ BT made a public announcement on its investments plans in the near future, i.e. in which UK regions it is planning to roll-out NGA network. According to its announcement, BT has pledged to spend £1.5 billion by 2012 to ensure that 40% of UK homes and businesses – some 10 million premises - can access fibre-based services. See for instance: <http://www.btplc.com/News/Articles/ShowArticle.cfm?ArticleID=9e80bccc-31e8-4588-b11a-e10c7d47e991>.

¹² Using DOCSIS technology, speeds of up to 20Mbps are already available, with higher speeds of 50Mbps planned to be rolled out in the near future.

technologies which have been rolled out in Cornwall and the Isles of Scilly show a 4-6 year delay for initial rollouts, which inevitably target the limited and most economically attractive urban areas.

Summary of Technology Arrival Dates in Cornwall and the Isles of Scilly compared to London

	Available in parts of Cornwall and the Isles of Scilly	Available in parts of London
DSL	2001	1996
ADSL2+	2010*	2006
WiMax type Services	unplanned	2003
3G Services	2005 - limited	2003
Local Loop Unbundling	2003 - limited	1998
Video On Demand	2007 - limited	1997
Cable with digital services	Unplanned**	2000
Virgin Media 50Mb NGB	Unplanned**	2009

* Based upon current roll out plans.

** With the possible exception of the only cable coverage in Cornwall and the Isles of Scilly.

IV. DESCRIPTION OF THE MEASURE

- (13) **Objective:** The project will aim to maximise the available coverage of next generation broadband across the county, aiming for 100% geographical coverage. The main objectives are the following: (1) Addressing market failure to deliver NGB networks (2) achieving distributional policy objectives by reducing regional disparities (3) increasing regional competitiveness.
- (14) **Legal basis:** The measure is based on (1) Regional Development Agencies Act 1998¹³, (2) No. 3623 European Communities, England The European Regional Development Fund (South West) Operational Programmes) (Implementation) Regulations 2007¹⁴, (3) Council Regulation (EC) No 1083/2006 – General regulation¹⁵, and (4) Council Regulation (EC) No 1080/2006 - ERDF¹⁶; (5) Council Regulation (EC) No 1084/2006 - Cohesion Fund¹⁷; (6) Commission Regulation (EC) No 1828/2006 - Implementing Regulation¹⁸, (7) the Operational Programme "Cornwall and the Isles of Scilly"¹⁹.
- (15) **Detailed mapping and coverage analysis:** The UK authorities conducted a detailed survey on the existing broadband infrastructures and services. In the UK market, two main operators, BT and Virgin have announced their nationwide plans

¹³ Available at: http://www.opsi.gov.uk/Acts/acts1998/ukpga_19980045_en_1.

¹⁴ Available at: <http://www.opsi.gov.uk/si/si200736>.

¹⁵ OJ L 210/25 of 31.7.2006.

¹⁶ OJ L210/1 of 31.07.2006.

¹⁷ OJ L210/79 of 31.07.2006.

¹⁸ OJ L 45/3 of 15.02.2007.

¹⁹ Commission decision C/2007/6580 of 13.12.2007.

for the next 3 years to provide NGA services across the UK. However, these investment plans will only limitedly take place in the Cornwall region. BT named the initial exchanges that will be upgraded, focusing on densely populated urban areas, and none of these plans include the Cornwall region. Virgin announced that it will upgrade its current cable infrastructure, but the cable coverage in the region is limited: only Saltash and Hatt, on the outskirts of the city of Plymouth (in Devon) are served by this cable network; this is estimated to cover less than 3% of the county's population.

- (16) **Public consultation:** The UK authorities verified the result of their mapping and coverage analysis and the investments plans of private operators for the next three years through an open and transparent consultation procedure. The UK authorities have undertaken detailed and significant public consultation with existing operators and other stakeholders.
- (17) Existing operators were consulted on the measure: 36 operators and other companies requested information (pre-qualification questionnaires) on the project. The consultation with the existing operators confirmed that, besides Virgin in the above referred areas, no private operator has plan to invest in the region in NGA networks within the next 3 years.
- (18) Consultations have been taken place between the current ULL operators to ensure that they will be able to easily and economically migrate their customers to the new network. Any required migration to a new fibre based infrastructure from the current copper network would be regulated by the national regulatory authority ("NRA"), Ofcom across the UK as a whole.
- (19) Ofcom was also regularly consulted throughout the process of selecting an investor and was informed of key decisions and milestones. Ofcom aim to ensure that access by service providers to active NGA products on an equitable basis is ubiquitous, and to ensure that competition can also develop at the infrastructure level with passive products should reasonable demand arise.
- (20) **Target areas:** As a result of the mapping and consultation with the stakeholders, the target area of the measure is the whole area of Cornwall region, except areas that are already served by the cable network. The measure will affect approximately 250,000 households and 25,000 businesses (that are almost exclusively SMEs).
- (21) **Budget and funding instruments:** The aid takes the form of a direct grant. The measure is identified as one of the primary objectives under Priority Axis 3, 'Transformational Infrastructure', of the Operational Programme "Cornwall and the Isles of Scilly" (2007–2013). This includes indicative European Regional Development Fund (ERDF) allocation of €47 million to €79 million to be used as funding, as necessary, to maximise coverage throughout Cornwall and the Isles of Scilly.
- (22) **Aid intensity:** Based on the result of the selection process, a level of gap funding of £53.5 has been identified (provided from the ERDF funds) that would be matched with additional £82.8 from the preferred bidder until the end of 2015 which would lead to an aid intensity of approximately 40%.

- (23) **Tender process:** The aid is allocated on the basis of a public tender. More specifically, the UK authorities followed the competitive dialogue procedure to select a preferred bidder in compliance with Directive 2004/18/EC²⁰.
- (24) **The award criterion** is the most economically advantageous tender in compliance with Article 29 (1) of the referred directive. The contract will be awarded for a period of 3 years with a possible extension of 2 years. The awarding authority set in advance the award components and the weight for each component: the amount of public funding required and the amount of private investment (20%), achieved geographical coverage (20%), the proposed technological solution (20%), end user applications (15%), tariffs and affordability (15%) and implementation and operation (10%).
- (25) **State of play of the tender process:** The preliminary Information Notice (ref 2008/S 225-299323) was published on 19/11/2008 to alert potential investors of the opportunity. The contract notice (ref. OJ 2009/S 52-074907) was published on 17/03/2009. Five organizations submitted a pre-qualification questionnaire ("PQQ") and all of them proceeded to the next stage of competitive procedure. Out of these five operators, the lowest scoring two participants were eliminated following a formal evaluation of the participants' proposed outline solutions and one more operator has withdrawn its bid. A series of dialogue meetings was held to develop and refine the Invitation to Submit Final Bid ("ITSFB") that was issued on 28/08/2009 to the two remaining participants. On 18/9/2009 one of the operators, the Babcock consortium informed Cornwall Council that they would not be submitting a final bid. The final bid was received from BT on 16/10/2009. A formal evaluation of the bid was undertaken in accordance with the process and the objective criteria set out in the ITSFB and BT was recommended as the preferred bidder to the project's Strategic Management Board.
- (26) **Objective to minimize public funding:** During the competitive dialogue, the Cornwall Council has encouraged participants to examine the opportunities of using all existing infrastructures and reduce costs that would score more highly under the evaluation criteria due to the lower aid amounts needed. Bidders during the tender procedure were considering using for instance sewer networks and existing telecommunication infrastructures. Bidders also planned to use the existing infrastructure of BT and Openreach that were available under the applicable regulatory framework. Openreach confirmed that the proposal offered to the downstream divisions of BT that were bidding in the selection process was also available to other bidding parties on request. Furthermore, Openreach took proactive steps to promote the opportunity to use its existing infrastructure by other electronic communication operators in case public funding is available to address the lack of adequate broadband infrastructure in a region²¹.
- (27) **Technology:** The UK authorities did not specify the technology in the invitation to tender, it was left to the operators what solutions they propose. The utmost objective of the UK authorities was to reach 100% NGA coverage on the targeted

²⁰ Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts. OJ L 134, 30.4.2004, p. 114–240.

²¹ See at: <http://www.openreach.co.uk/orpg/news/productbriefings/nga/nga01509.do>.

areas with the widest possible fibre to the premises coverage that are considered as future proof solutions and could deliver the project objectives.

- (28) The preferred bidder plans to cover the majority of the target areas with a mix of FTTP²² and FTTC²³ solutions ("FTTx" solutions) covering 86% of the premises. Where the costs of deploying fibre technology were prohibitive, the UK authorities accepted that the preferred bidder will provide basic or advanced basic broadband services via satellite, wireless and ADSL2+ broadband technology platforms²⁴. That concerns approximately 14% of the premises, typically where existing broadband infrastructures do not exist or cannot provide minimum download speeds of 2 Mbps at affordable prices.
- (29) **Wholesale access:** Third party access includes both passive and active infrastructure²⁵. In this respect, the UK authorities also undertook a public consultation on the type of access products alternative operators may be interested in and also took full consideration of the recommendations of Ofcom²⁶. The result of such consultation indicate that in such predominantly rural area like Cornwall, alternative operators are typically not interested in passive access products since it would not be economic to build a parallel NGA-type of network. Alternative operators in general have strong interest in active access products because, *inter alia*, less investment is required than when using passive products; services can be established rapidly as local infrastructure build is not required; all customers on a network can be addressed at once, relatively little additional investment is needed to maintain this as the coverage of the network grows; and with standardised active products, there is the potential for a single retail product to be readily offered to customers served by many different access networks. The result of such public consultation was also taken into account when designing the access conditions of the scheme.
- (30) Concerning the active access, third party operators will have wholesale access to the subsidised broadband networks in a non-discriminatory way during a period of minimum 7 years from the completion of the project²⁷. This can be prolonged if the operator of the infrastructure in question has significant market power in the specific market concerned. The selected operator will be obliged under the terms of its contract to ensure that at least 10 other operators are actively offering services using the new network.

²² Fibre to the Premise continues the fibre optic cable that arrives at the telephone exchange on to the end user, giving them a future proofed fibre optic connection to the internet. It provides speeds download speeds of 100 Mbps per customer at launch.

²³ Fibre to the Cabinet (FTTC) continues the fibre optic cable that arrives at the telephone exchange on to the more locally based 'cabinets'. It uses Very high speed Digital Subscriber Line (VDSL2) technology to provide speeds of up to 40 Mbps per customer at launch.

²⁴ These technological solutions will be implemented by BT's partners, Avanti (satellite) and Motorola (wireless).

²⁵ With the exception of the limited wireless and satellite solutions, since no passive remedy is available for these technologies. Concerning these solutions, wholesale active access will be provided on an equitable basis to all operators wishing to offer a service.

²⁶ See public consultation in relation to "*Delivering super-fast broadband in the UK – promoting investment and competition*". Available at: http://www.ofcom.org.uk/consult/condocs/nga_future_broadband/statement/statement.pdf.

²⁷ The wholesale products will ensure that all competing LLU operators will have the ability to reach all FTTx customers economically in Cornwall.

- (31) Concerning the passive access, the selected operator will offer access to ducts and pole sharing in accordance with Ofcom's requirements. To the extent the measure supports FTTC infrastructure, the selected operator will be offering an existing sub-loop unbundling (SLU) product that provides access to the street cabinets. This SLU product is also regulated by Ofcom.
- (32) **Benchmarking:** A price benchmarking mechanism is incorporated in the contract with the preferred bidder. The price for wholesale access will be based on average prices for comparable services in more competitive areas of the UK and EU. The NRA and the public authorities will monitor and approve the pricing of broadband services.
- (33) **Beneficiaries:** The direct beneficiaries of the aid will be electronic communications operators offering broadband services. Indirect beneficiaries will be electronic communication operators utilising the new network for offering retail services to end users, residential users and primarily SMEs in the areas concerned who will benefit from better broadband services.
- (34) **Duration of the measure:** The Lifetime of the Project is defined as ending on 31/12/2015. The Lifetime of the Grant Award is defined as ending on 30/6/2013. The aim of the UK authorities is that NGA services are available late 2010 or early 2011. The preferred bidder confirmed it has no plan to cease operation of the network at the end of the project, and would expect to upgrade it over time. However, even if these circumstances change, the preferred bidder confirms that network operation would continue in order to provide the minimum 7 years of open access, as specified in the Broadband Guidelines.
- (35) **Monitoring and clawback mechanism:** The measure will comply with the approved EU regulatory and monitoring processes. The selected bidder will be required to maintain separate accounts for the subsidised activity to avoid cross-subsidisation of other commercial activities and to facilitate the monitoring of profit levels. The monitoring will be overseen by the Executive Group²⁸, which will manage the delivery of the project on a daily basis. The UK authorities will be in a position to recover some, or all, of the grant if the preferred bidder is in breach of the Funding Agreement. This includes any significant failure to achieve the predefined key performance indicators²⁹; a lack of progress towards achieving the targets; or a breach of the Structural Funds Regulations. A claw-back mechanism will also be part of the contracts: the preferred bidder will pay back part of the state aid to the UK authorities if the demand for broadband in the target area grows beyond anticipated levels and this leads to a situation where the support granted is deemed to be unreasonably high during the lifetime of the project. Any extra profit will be calculated annually and, at the end of the lifetime of the project, the cumulative calculation will determine the amount of the funding to be paid back. Repayment will be capped at the amount of the state aid involved in the measure.
- (36) **Complementary activities:** Demand stimulation is considered to be an essential element of the project in order to maximise take up and the economic benefits to the region. Activities are planned to take place at two levels – promoting the

²⁸ The Executive Group will be hosted by the Cornwall Development Company, a wholly owned company of Cornwall Council.

²⁹ Such as indicators for coverage, marketing spend milestones, number of service providers, network performance.

wholesale services to ISPs, and promoting and educating consumers about end user applications. A separate but complementary project to provide specialist ICT business support will be delivered in parallel to the NGB deployment. The focus of the business support activity will be on ensuring businesses increase GVA through transformational use of the NGB network.

- (37) **Anticipated benefits:** Research commissioned by the South West Regional Development Agency³⁰ highlights the transformational impact ICT can have on Cornwall and the Isles of Scilly's economy. It is estimated that investment in next generation broadband could lift the GVA of Cornwall region by as much as £400m over the next 5-7 years. According to the UK authorities, the investment in next generation broadband aims to create 4,000 jobs and safeguard 2,000 jobs. Furthermore, the aim is to ensure that the jobs created will be high value jobs that will lead to a step change in Cornwall region's underperforming economy. The UK authorities argue that the current measure is in line with the Lisbon Agenda, the European Information Society 2010 and has the potential to improve the environment³¹.

V. THE VIEW OF THE COMPLAINANT

- (38) The complainant is the CEO of Vtesse, which provides *inter alia* broadband services in the UK, who raised several issues concerning the measure and the UK broadband market in general. Vtesse participated in the tender procedure related to the measure in consortium with Babcock International Group, but at the end, the consortium decided not to submit a final bid³². In the current case, only the claims relevant to the current measure will be examined in detail³³, the general claims about the UK broadband market will be investigated as part of a separate complaint³⁴. The complainant also raised some claims on the UK's application of the tax on non-domestic property to telecommunication infrastructure, on which the Commission has taken a final decision, and which has been appealed by the complainant and is currently pending before the General Court³⁵. The current decision is without prejudice to any other Commission investigations related to other complaints or the ongoing Court proceedings.
- (39) First, the complainant asks whether it was right for BT to gain a concession very early in this market, which effectively forecloses the market to new entrants such as the complainant's company.

³⁰ Cornwall's Economy and ICTs, Adroit Economics, January 2008. Available at: <http://www.actnowcornwall.co.uk/documents/Cornwalls-economy-and-ICT-main-report.pdf>.

³¹ The *actnow flex* project worked closely with 50 SMEs in Cornwall and the Isles of Scilly and the southwest to help them introduce flexible working practices and measure the productivity, environmental and social impact. Results showed that: 76% of businesses used less fuel for travel, 83% of employees reduced commuting, saving a significant amount of CO2 annually.

³² See paragraph (25).

³³ Registered as CP335/2009 "*Complaint on the Cornwall broadband scheme*" in the Commission's registry.

³⁴ Registered as CP294/2009 "*Complaint on BT*" in the Commission's registry.

³⁵ Commission decision in case C4/2005 - *Property tax on telecommunication infrastructure*. JOCE L/383/2006. Reference Court Case: T-54/07: Action brought on 19 February 2007 - Vtesse Networks v Commission.

- (40) Second, the complainant questions why concessions should be granted to BT with no geographic discrimination across the UK when it is principally targeting areas that are already cabled, and therefore capable of getting DOCSIS 3.0.
- (41) Third, the complainant asks whether it would be right for ERDF funding to be given to BT when it had refused to supply an essential facility, foreclosed the market to others, and thus determined the outcome of a competitive process through the actions of Openreach³⁶, which is meant to deal with all communication providers equally.
- (42) Fourth, the complainant asks, given that Ofcom is only just about to undertake a study into Market 4 (in which on facts BT has SMP in Hatt and Saltash), and the draft Commission Recommendations on NGA are only likely to come into force later this year, is it right for the Cornwall Authorities to continue with a process that precludes consideration of regulatory change which could alter the outcome of the bidding procedure, to the detriment of the citizens in Cornwall.
- (43) In summary, the complainant requires assistance in persuading the UK authorities to allow passive access remedies in Cornwall that would allow them to be able to compete on equal terms with BT.

VI. THE VIEW OF THE UK AUTHORITIES

- (44) The UK authorities consider all point raised by the complainant unfounded or the UK authorities are of the opinion that the claims brought forward are not matters to address in relation to the Cornwall scheme.
- (45) As regards the first point raised by the complainant, according to the UK authorities, no action has been taken against BT for any exclusionary abuses that actually or potentially foreclose the market to new competitors, under either the Chapter II Prohibition or Article 82 of the EC Treaty³⁷, by either the UK competition authorities or by the Office of Fair Trading. According to the UK authorities, the complainant has not detailed exclusionary behaviour which would exclude new entrants from the market, for example by the use of predatory pricing (i.e. selective price reduction intended to harm a new competitor), tie-ins (i.e. requirements upon customers to obtain supplies of a tied product when purchasing the tied product) or discounts, loyalty schemes or fidelity rebates. Furthermore, the UK authorities emphasize that the selected bidder will be required to comply with all current and future UK regulations related to NGA. For these reasons the UK authorities do not believe the measure of the preferred bidder forecloses the market to new entrants in Cornwall and Isles of Scilly.
- (46) As regards the second point raised by the complainant, the UK authorities highlight that their notification paper describes Cornwall and Isles of Scilly as a "grey area" in terms of current broadband (with the exception of a small cabled area in Saltash and Hatt estimated to provide 3% cable coverage) and a "white area" in terms of NGA. The negligible cable coverage is one of the factors that lead to the

³⁶ Openreach is a division of BT Group, but it operates as a separate line of business - serving the needs of all communications providers. Following an agreement with Ofcom, the division was created to control the local loop and to ensure that all communications providers have equality of access to BT's own local network.

³⁷ With effect from 1 December 2009, Article 82 of the EC Treaty has become Article 102 of the TFEU.

conclusion that there is minimal prospect of a private sector operator investing in a NGA network in Cornwall and Isles of Scilly on market terms. Therefore any public sector gap funding will exclude the small area served by the cable network. The UK authorities also note that, in general, the cabled areas in the UK (approximately 50% coverage) are the black areas of no market failure and are therefore likely to be the most attractive areas for NGA investors.

- (47) As regards the third point raised by the complainant, the UK authorities argue that while they are not in a position to express a view on such an assertion, the preferred bidder has confirmed that all Openreach products have been and will be accessed in compliance with „equivalence of input" principles. BT's downstream divisions will consume standard products from Openreach. These standard products are and will be available to all communication providers on an equivalent basis. Furthermore, the UK authorities note that any breach of the „equivalence of input" principles would clearly be a matter for Ofcom and not Cornwall Council, and they have been assured by Ofcom that they have not received any specific complaint in relation to this matter as at 12 November 2009.
- (48) As regards the fourth point raised by the complainant, the UK authorities have been in contact with both the European Commission and Ofcom throughout the process of selecting a preferred bidder under the competitive dialogue procedure. The Invitation to Submit Final Bid has been designed to be consistent with current regulation, specifically the Ofcom statement „Delivering super-fast broadband in the UK"³⁸. The preferred bidder will comply with all current and future regulation related to NGA. The UK authorities also stress that any significant delays in the project would risk securing the already earmarked EU funding. The UK authorities believe that the 2007-13 Operational Programme 'Cornwall and the Isles of Scilly' represents Cornwall's last opportunity to make a significant investment in the digital infrastructure that will provide the platform for economic transformation. In the absence of such EU funding and the current measure, the Cornwall region will not benefit from significant NGA investments in the near future thereby bringing the region in a significant competitive disadvantage to other regions of the UK and Europe.
- (49) On the passive access remedies, the UK authorities confirmed that the project will assess demand for passive access through the regular updates that will be held with communication providers. The preferred bidder will offer the following passive access products to third parties in an open, non-discriminatory way: (i) the project will benefit from the provision of cost orientated passive access to ducts and poles on the whole of the subsidized network. (ii) The project will benefit from the provision of cost orientated passive access to the copper sub-loop in the FTTC areas. (iii) The project will benefit from the provision of backhaul measures. In providing backhaul services to its nearest point of presence, BT is required by the undertakings that it gave to Ofcom in 2005 under the Enterprise Act 2002 to provide these on an equivalence of inputs basis, i.e. on the same terms and conditions, including the price that it offers to its own downstream businesses. The same undertakings require BT to meet reasonable demand for access to street cabinets. All access products will be approved by the NRA under the applicable regulatory framework. The UK authorities argue that thanks to the strong active

³⁸ For reference, see footnote 26.

and passive open access provisions of the current scheme, the measure will lead to a significantly more competitive market in Cornwall than currently available.

VII. ASSESSMENT OF THE MEASURE: PRESENCE OF AID

- (50) According to Article 107 (1) TFEU, “*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market*”. It follows that in order for a measure to qualify as state aid, the following cumulative conditions have to be met: 1) the measure has to be granted out of State resources, 2) it has to confer an economic advantage to undertakings, 3) the advantage has to be selective and distort or threaten to distort competition, 4) the measure has to affect intra-Community trade.

State resources

- (51) The measure is financed by EU funds, which qualify as state resources once they come under the control of a Member State.

Economic advantage

- (52) *Selected operators*: Through the tender process, the selected operator will receive financial support which will enable it to enter the market and provide very high speed broadband services on conditions not otherwise available on the market. Although a competitive tender procedure tends to reduce the amount of financial support required, the aid will also allow the operator to offer end-to-end services *prima facie* at lower prices than if it had had to bear all costs themselves and thus attract more customers than under normal market conditions. In view of the above, an economic advantage will be granted to the selected operator.
- (53) *Third party providers*: Third party electronic communication providers will be able to offer their services by using the active and passive wholesale access of the subsidized network on open, non-discriminatory terms. They will therefore also indirectly benefit from the state resources, as they will be customers of the selected electronic communication operator.
- (54) *End users*: The measure aims at improving the provision of existing broadband services to business users and residential users. Whereas residential users are not subject to state aid rules, businesses (SMEs in particular) in the targeted areas will therefore ultimately benefit from the improved broadband services and coverage in comparison with what would be provided on a purely commercial basis.

Distortion of competition

- (55) The intervention of the State alters the existing market conditions by allowing the provision of improved broadband services by the selected electronic communication operator and, potentially, third party providers. Furthermore, the measure will alter the conditions of competition between end users who are likely to subscribe to the very high speed broadband services in the targeted areas and end users elsewhere in the UK and the EU. Therefore, the fact that an improved broadband service becomes available has the effect of distorting competition.

Effect on trade

- (56) Insofar as the intervention is liable to affect providers of electronic communications services from other Member States, the measure has an effect on trade. The markets for electronic communications services are open to competition between operators and service providers, which generally engage in activities that are subject to trade between Member States. Moreover, the measure has the potential to distort competition between end users located in the Cornwall region and elsewhere in the EU.

Conclusion

- (57) The Commission therefore concludes that the notified aid measure constitutes State aid within the meaning of Article 107 (1) TFEU as moreover confirmed by the notifying Member State during the notification. Having established that the project involves aid within the meaning of Article 107(1) TFEU to the selected service provider, third party providers and businesses, it is necessary to consider whether the measure can be found to be compatible with the internal market.

VIII. ASSESSMENT OF THE MEASURE: COMPATIBILITY

- (58) The Commission has assessed the compatibility of the scheme according to Article 107(3)(c) TFEU and in the light of the *Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks*³⁹. The Broadband Guidelines contain a detailed interpretation of Article 107(3)(c) TFEU in this area of State aid law.

VIII.1. The balancing test and its application to aid for the broadband network deployment

- (59) As described in paragraphs 34 and 35 of the Broadband Guidelines, in order to assess whether a measure is compatible under article 107(3)(c), the Commission balances positive and negative effects of the aid according to the criteria set out in the Guidelines. In applying the balancing test, the Commission will assess 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?
 - (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?

³⁹ OJ C 235 of 30.9.2009, p. 7.

VIII.2. Objective of the measure

The aid is in line with the EU policy

- (60) The current measure targets areas where no NGA broadband coverage is currently available and where there are no plans by private investors to roll out such infrastructures in the near future of three years. The measure will contribute to achieve the EU's paramount objective of "broadband for all" by enabling the households and businesses in Cornwall region to have access to affordable high speed or very high speed broadband services. The objective of the measure is in line with Section 3.1 of the Broadband Guidelines: by extending very high speed broadband coverage to areas where private operators have no commercial interest to invest, the UK authorities pursue genuine cohesion and economic development objectives. The measure is therefore in line with the common interest.

Aid is the appropriate instrument

- (61) Alternative instruments, such as demand side measures could provide grants or tax incentives to end users. However, in the situation currently under assessment, the efforts from alternative instruments (including *ex ante* regulation) do not solve the problems related to the lack of supply (non-existence of infrastructure) of basic or high speed broadband in the targeted areas and would fail to deliver the wider economic benefits of a widespread next generation broadband network. In line with paragraphs 47 and 48 of the Broadband Guidelines, in order to ensure the supply of basic and high-speed broadband services, the UK authorities see no alternative but to grant public aid to the construction of basic and NGA broadband networks in the targeted areas of the country.
- (62) The Commission can agree that without further public intervention, avoiding the emergence of a new "*digital divide*" between rural and urban areas seems not possible, which could lead to the economic and social exclusion of the local citizens and undertakings. Hence in the current situation, State aid is an appropriate instrument to achieve the set objectives.

The aid provides the right incentives to operators

- (63) Regarding the incentive effect of the measure, the Broadband Guidelines set out in paragraph 50 that it needs to be examined whether the broadband network investment concerned would not have been undertaken within the same timeframe without any State aid. The market analysis and the public consultation described in Section III.3 and paragraph (16) of the current decision will guarantee that in the targeted areas no high speed or very high speed broadband network investment would take place without public funding in the near future of three years, hence the aid produces a change in the investment decisions of the operators. Moreover, as explained in paragraph (23), the recipient of the aid is selected by public tender. Therefore, the aid should provide a direct and appropriate investment incentive for the selected operators.

VIII.3. Design of the measure and the need to limit distortions of competition

- (64) The measure predominantly supports the provision of NGA networks, but in order to achieve the objective of the "broadband for all", it also supports the extension of basic broadband services (such as ADSL2+, satellite and wireless solutions), where the costs of deploying fibre technology were prohibitive as described in paragraph (28). These are typically areas where basic broadband services currently do not

exist or where such services at a minimum (download) speed of 2 Mbps are not available at affordable prices and where there are no plans by private investors to roll out such an infrastructure within the next three years. In line with the Commission's case practice, such areas shall be considered as "white areas"⁴⁰ and the measure shall be compliant with the conditions laid down in paragraph 51 of the Broadband Guidelines.

(65) In order to minimise the State aid involved and the potential distortions of competition, the notified measure has to meet a number of necessary conditions.

(a) *Market research and consultation:* As set out in detail in paragraphs (15) to (19), the UK authorities undertook a detailed analysis of the existing broadband infrastructure in order to clearly identify the areas where state intervention is necessary. The consultation with existing operators through an open, transparent way ensures that public funds are used only in areas where such private investments do not exist and not planned in the near future. By conducting in parallel an analysis of the competitive conditions and structure prevailing in the given area and consulting with all stakeholders affected by the relevant measure, the UK authorities ensure to minimise distortions of competition with existing providers who had plans to invest in the near future in the area and also those who are currently using the existing infrastructure.

Contrary to the allegations of the complainant described in paragraph (46), the current measure does not target areas where cable infrastructure is already present (see paragraph (20)), precisely because the operator, Virgin cable indicated that it has investments plans to upgrade its current cable infrastructure in the near future of three years. The Commission concludes that the detailed market research or "mapping" together with the wide public consultation conducted by the UK authorities will limit any potential distortion of competition *vis-à-vis* existing operators and reduce the amount of State aid required for the measure.

(b) *Open tender process:* The UK authorities selected the preferred bidder for the construction and the management of the network in an open, non-discriminatory and competitive tender process in full compliance with national and EU public procurement principles. This procedure has the effect of maximising the effect of the aid provided while minimizing any potential advantage granted for the selected operator.

(c) *Most economically advantageous offer:* Within the context of an open tender, the UK authorities selected the most economically advantageous offers among those presented by the operators. Under the terms of the open tender, the bidder with the lowest amount of aid requested received more priority points within the overall assessment of the bid as explained in paragraph (24). Furthermore, in line with footnote 55 of the Broadband Guidelines, for the purposes of determining the most economically advantageous offer, the awarding authority specified in advance the relative weighting which it gave to each of the (qualitative) criteria chosen as described in paragraph (24).

⁴⁰ See for instance Commission decision of 23.02.2009 in State aid case N 238/2008 – *Germany Broadband infrastructure development in Germany*. JOCE C/154/2009.

- (d) *Technological neutrality*: The measure does not favour any technology or network platform leaving it to commercial operators to come up with the most appropriate technological solutions to provide very high speed broadband services to end users. Bidders were entitled to propose the provision of the required broadband services using or combining whatever technology they deemed most suitable.
- (e) *Use of existing infrastructures*: To avoid unnecessary and wasteful duplication of resources, the UK authorities encouraged the use of existing infrastructure. In this way the bidders were encouraged to have recourse to any available existing infrastructure in the area so as to avoid unnecessary and wasteful duplication of resources and to lower the aid amount necessary. In order to try and limit the economic impact on existing network operators, such bidders (or consortium of bidders) were given the possibility to contribute their infrastructure to the notified project, which possibility included the use the products from Openreach and BT Wholesale that were available under the UK's regulatory framework. The use of existing infrastructure could allow bidders to reduce their investment costs, however in the current situation, the UK authorities stressed that for a bidder to be selected, it had to comply with a wide range of criteria (described in detail in paragraph (24)) that no single aspect of the solution (including the possible use of existing infrastructure) could overly influence the overall solution or distort the outcome of the evaluation. The Commission also takes note on the confirmation of the UK authorities that the proposal on the use of existing infrastructure offered to preferred bidder was also available to other bidding parties on request as described in paragraph (26).
- (f) *Wholesale access*: The selected operator will have to offer wholesale services and access to the subsidised network to other operators for at least 7 years. The selected operator will have to offer other operators access to a network element or to the capacity of the network in an open, transparent and non-discriminatory manner. The wholesale access enables third party operators to compete with the selected bidder (when the latter is also present at the retail level), thereby strengthening choice and competition in the areas concerned by the measure while at the same time avoiding the creation of regional service monopolies.

In relation to the allegation by the complainant regarding that BT allegedly forecloses the market to new entrants⁴¹, and whether it would be right for ERDF funding to be given to BT when it had refused to supply an essential facility, foreclosed the market to others, and thus determined the outcome of a competitive process through the actions of Openreach, which is meant to deal with all communication providers equally⁴², the Commission notes since the preferred bidder is designated by the NRA under the applicable regulatory framework as having significant market power (SMP), it will have to comply with all the access obligations imposed under the applicable Regulatory Framework. Furthermore the preferred bidder will have to comply with all open access conditions set out in the relevant Commission legislation, the Broadband Guidelines as laid down in the current Commission decision. The NRA, Ofcom will regulate ex ante and monitor very closely the competitive conditions of the overall broadband market and impose where appropriate the necessary remedies

⁴¹ Paragraph (39).

⁴² Paragraph (41).

provided by the applicable regulatory framework. Furthermore, according to the conditions imposed by the UK authorities, the selected operator will be obliged under the terms of its contract to ensure that at least ten other operators are actively offering services using the new, subsidized network as described in paragraph (30). Openreach products are accessed in compliance with „equivalence of input" principles which would allow all access products to be available to all communication providers on an equivalent basis. Such obligation is subject to regulatory supervision by the NRA. Hence, there is no evidence that the preferred bidder of the current measure will be able to prevent the market entry of alternative operators or would hamper the alternative operators to use the subsidized network contrary to the common interest; and the access obligations - as approved in this decision and monitored by the NRA - will guarantee the availability of the subsidized infrastructure to third party operators on open, non-discriminatory conditions.

- (g) *Benchmarking pricing exercise:* In order to ensure effective wholesale access and to minimise potential distortion of competition, access wholesale prices should be based on the average published (regulated) wholesale prices that prevail in other comparable, more competitive areas of the country and the EU. Wholesale prices on the subsidized network will be monitored and approved by the NRA with the objective to keep these at a reasonable and non-discriminatory level.
 - (h) *Monitoring and claw-back mechanism to avoid over-compensation:* The project will be examined on a regular basis and the monitoring mechanisms implemented will ensure that any extra profit generated through the operation of the networks will be clawed back. Thereby the UK authorities ensure that the recipient of the aid will not benefit from overcompensation and will minimise *ex post* and retroactively the amount of aid deemed initially to have been necessary.
- (66) To the extent the measure aims to support the deployment of an NGA network in "white NGA areas", where one basic broadband network may already exist (traditional "grey area") further conditions shall be met as laid down in paragraph 73 of the Broadband Guidelines. In this respect, the UK authorities proved that
- (i) the broadband services provided over the existing networks are not sufficient to satisfy the continuously growing needs of citizens and business users in the area in question and commercial operators do not have sufficient commercial incentives to upgrade the existing networks as described in detail in section III.3;
 - (j) there are no less distortive means (including *ex ante* regulation) to reach the stated goals as described in paragraph (61).
- (67) Concerning the conditions laid down in paragraph (79) of the Broadband Guidelines, the UK authorities proved that the following conditions are met not only to the extent the measure supports NGA networks but concerning the whole subsidized network:
- (k) The access obligations imposed on the chosen operator include access to both passive and active infrastructure for at least 7 years without prejudice to any similar regulatory obligations that may be imposed by the NRA. The access obligation imposed also includes the right to use ducts or street cabinets in order to allow third parties to have access to passive and not only active

infrastructure⁴³. This is without prejudice to any similar regulatory obligations that may be imposed by the NRA in the specific market concerned in order to foster effective competition or measures adopted after the expiry of that period.

- (l) As detailed in paragraph (19), in setting the conditions for wholesale network access, the UK authorities consulted the NRA. The NRA will continue either to regulate ex ante and to monitor very closely the competitive conditions of the overall broadband market and impose where appropriate the necessary remedies provided by the applicable regulatory framework. Furthermore, the NRA – under the relevant regulatory obligations - will set the access conditions under applicable national and EU rules.

As regards the point raised by the complainant whether it is right for the UK authorities to continue with the measure that allegedly precludes consideration of regulatory change (for instance, the analysis of Market 4 by Ofcom or the Commission's NGA Recommendation)⁴⁴, the Commission notes that the State aid approval of any broadband measure is without prejudice to any similar regulatory obligations that may be imposed by the NRA⁴⁵, hence the current measure will also fully oblige with any change in the applicable regulatory frameworks. The measure is fully in line with the Commission's objective to foster the rapid deployment of NGA networks in areas where private operators have no plans to invest in the near future of three years as laid down in the Broadband Guidelines.

- (m) As detailed in paragraphs (29) to (31), the NGA network architecture that will benefit from State aid will support effective and full unbundling and satisfy all different types of network access that operators may seek⁴⁶, including active and passive access products on an open wholesale basis.

VIII.4. The distortions of competition and the effect on trade are limited, so that the overall impact of the measure is positive

- (68) The Commission concludes that the notified measure will offset a geographical and commercial handicap and is objectively justified to address the lack of availability of very high speed broadband services due to the commercial unattractiveness of upgrading existing broadband services.
- (69) In view of the characteristics of the project and of the safeguards applied by the UK authorities, the overall impact on competition is deemed to be positive.
- (70) On balance, the Commission concludes that the overall effect of the measure is deemed to be positive. The measure is in line with the objectives of Article 107(3)(c) of the TFEU as it facilitates the development of certain economic activities (high speed broadband services) in certain remote and rural areas. The intervention is designed in a way that does not distort competition or adversely affect trading conditions to an extent contrary to the common interest.

⁴³ Passive access remedies are technologically not feasible in case of certain basic broadband technologies as described in footnote 19.

⁴⁴ Paragraph (42).

⁴⁵ See paragraph 79 of the Broadband Guidelines.

⁴⁶ As evidenced by the public consultation described in paragraph (29).

VIII.5. Conclusion

- (71) The Commission concludes that the compatibility criteria set out in the Broadband Guidelines are met, hence the aid involved in the notified measure is compatible with Article 107(3)(c) TFEU in conjunction with the Broadband Guidelines. In view of the duration of the scheme, the Commission would like to draw the UK authorities' attention to future revisions of the Guidelines, which might make appropriate measures to the scheme necessary.

IX. DECISION

- (72) On the basis of the foregoing assessment, the Commission has accordingly decided that the aid measure "*Cornwall & Isles of Scilly Next Generation Broadband*" is compatible with Article 107(3)(c) TFEU.
- (73) The UK authorities are reminded that, pursuant to Article 108(3) TFEU, they are obliged to inform the Commission of any plan to extend or amend the measure.
- (74) 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/state_aids_texts_en.htm.

- (75) Your request should be sent by encrypted e-mail to stateaidgreffe@ec.europa.eu or, alternatively, by registered letter or fax to:

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State Aid Greffe
Rue Joseph II. 70. 03/225
B-1049 Brussels
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Yours faithfully,

For the Commission

Dacian CIOLOȘ
Member of the Commission