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**Subject: State aid SA.33063 – Italy  
Trentino NGA**

Sir,

The Commission wishes to inform the Italian Republic that, having examined the information supplied by your authorities concerning the project by the Provincial authorities of Trento (PAT) to create a public-private partnership for the rollout of a Next Generation Network (NGN) infrastructure, it has decided to open a formal investigation under Article 108(2) TFUE.

## **1. PROCEDURE**

- (1) On 24 May 2011, the Commission received a complaint by the three main alternative telecom operators active in Italy (Wind, Fastweb and Vodafone). In their detailed submission, it was alleged that a project launched by the Italian Province of Trento (PAT) in northern Italy for the deployment of an NGA infrastructure throughout the territory of the province constituted de facto state aid to Telecom Italia (TI), granted in violation of the competition rules as stated in the Broadband Guidelines. In particular, the complainants lament the fact that they were not properly informed nor consulted by the PAT on the Province's plans and objectives, that the beneficiary was predetermined before the start,

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that the chosen infrastructure will not allow real competition after it has been deployed.

- (2) Following a request for information sent on 22 June 2011, the Italian authorities requested a meeting in July and subsequently on 20 July 2011 they submitted a holding reply, contending that their intention was to follow the Market Economy Investor Principle (MEIP), that their intervention did not constitute State aid and thus did not need to fulfil the compatibility conditions of the Broadband Guidelines. The provincial authorities indicated that they were still in the process of preparing a business plan with private partners and that they would come back with more detailed information in due time.
- (3) On 4 November 2011, after clearing the confidentialities, the reply by the Italian authorities was forwarded to the complainants who submitted additional observations and documentation on 29 November, 7 and 16 December 2011.
- (4) In January 2012, the Italian authorities submitted to the Commission more detailed information on the project, including, in particular, the shareholders' agreements and a due diligence report by an independent consultant on the Business Plan. On this basis, a meeting took place on 23 February 2012 in which representatives of the PAT sought to better clarify their position.
- (5) In the subsequent weeks, the Commission services have been in close contact with all parties involved. Various meetings and phone conferences were held with each of the parties.
- (6) The PAT sent additional information and clarifications, including expert reports and modifications to the shareholders' agreements as well as an evaluation on their MEIP case on 27 February, 14 March, 26 March, 13 April, 24 April and 16 May 2012. The complainants also submitted additional information and documentation on 20 February, 30 March, 15 May and 21 May 2012.

## **2. DESCRIPTION OF THE MEASURE**

- (7) In September 2010, PAT elaborated a comprehensive strategy to achieve their connectivity objective of 100% coverage of its territory by a "ultra-broadband fibre network" by 2018. The strategy foresees two types of action for two different types of areas in the provincial territory: for 60% of the population, a NewCo ("Trentino NGN") would be created by the PAT and open to the participation by private partners. The areas chosen as falling within the scope of action of Trentino NGN were those of "medium-profitability" (high-profitability areas have been excluded in the provincial territory) identified with municipalities in which the cost of deploying the fibre-to-home (FTTH) infrastructure would remain just around EUR 1.000 per household, i.e. 42 municipalities and 150.000 households, corresponding to 60% of the provincial population. The remaining part of the PAT's territory, composed only of "low profitability" areas, would be the target of an ad hoc state aid measure to be developed and notified in the future, probably under the supervision of PAT's publicly owned company "Trentino Network" – different from Trentino NGN

and currently in charge of other interventions falling with the general broadband strategy of the PAT.

- (8) In the following months, separate contacts between PAT and several private operators took place and on 8 February 2011 the PAT signed a Memorandum of Understanding (MoU) with TI for the creation of Trentino NGN to deploy a FTTH infrastructure in the abovementioned "medium profitability" areas. Pursuant to this initial agreement, the PAT committed to a cash contribution of up to 60 million EUR to the capital of Trentino NGN, while TI would make only contributions in kind, including (1) its existing passive infrastructure (ducts and poles) immediately and (2) the switch-off of the existing copper network after the FTTH network enters in operation.
- (9) Later in 2011 two other minor private shareholders also joined the MoU: a financial institution "Finanziaria Trentina" and a smaller Internet service provider "McLink", each making smaller financial contributions to the company.
- (10) By December 2011, the business plan was finalised and a due diligence report was prepared by Analysys Mason on request by the PAT. At the same time, the shareholders' respective rights and obligations were finalised and the contributions in kind by TI to Trentino NGN were more precisely defined. Further amendments to the shareholders' agreements were introduced after discussions with the Commission and completion of an expert report on the project by Analysys Mason. By March 2012, the required expert report on TI's first contribution in kind was prepared by Reconta Ernst & Young, which led to a further adjustment. On 18 May the joint venture "Trentino NGN" becomes operational.
- (11) The resulting scenario looks as follows:
  - The PAT creates single-handedly the company "Trentino NGN" with minimal capital contribution of less than EUR 100.000. Through an increase in the equity capital, to be implemented after finalisation of the agreements with private shareholders, the company will reach its final setting.
  - At the end of the negotiation phase, announced in the press release of 18 May 2012, the equity capital of Trentino NGN is increased as follows: the PAT contributes 50 million EUR, corresponding to a share of 52,2%, Finanziaria Trentina will contribute 5 million EUR (5,2% share), McLink 1 million EUR (1,6% share) and TI the lease, by means of indefeasible rights of use (IRUs), of its passive infrastructure (ducts and poles) in the whole territory of the Province, which will be used for the construction of the new fibre network ("first contribution"). TI's first contribution was initially valued at 39,8 million EUR but the report by Enrst & Young on the value of this contribution indicated a slightly lower amount of 39,3 million EUR, which lead to an update in the agreement. The share of TI's participation in Trentino NGN after the first contribution corresponds to 41,1%. It is expected that the first contribution will allow saving [between 23 and 30%] of the total civil works for the deployment of the fibre network.

- Pursuant to the shareholders' agreement, as of the end of the 3rd year from the first contribution or as of the activation of at least *[between 14 and 21%]* of the new fibre connections, both TI and the PAT may decide to initiate the "second contribution" by TI, i.e. the transfer to Trentino NGN (i) of the ownership (as opposed to the IRUs already conferred) of the passive infrastructure existent in the medium profitability areas targeted by Trentino NGN (ii) the ownership of the copper network, with a view to switching it off and migrating all customers on the new fibre network. The value of the contribution has been determined in *[between 480 and 560]* EUR per active copper line, including both TI's retail lines and lines operated on behalf of the operators having unbundled access to the local loop (ULL). This value is increased by [...] million EUR corresponding to the value of converting the IRUs on the ducts space (i.e. the first contribution) into ownership. In this second phase and thanks to the second contribution, TI will acquire the majority stake and control of Trentino NGN, if necessary by an additional capital injection by TI.
- Finally, after 3 more years or after reaching the objective of *[between 35 and 50%]* active and connected lines, TI has the right to exercise a call option vis-à-vis the PAT and McLink to acquire their share of Trentino NGN. In return for the concession of this right to TI, and *if* it is eventually exercised, TI will pay [...] million EUR to the PAT, half within one year and half within two years. The purchase price for the shares will be equal to the value of the contribution increased by an annual [...], net of the distributed dividends<sup>1</sup>. The other two shareholders, McLink and Finanziaria Trentina are granted a put option whereby they may decide to sell their share in Trentino NGN to TI at a price corresponding to the value of their contribution increased by respectively [...] and [...] per year.
- With specific shareholders' agreements, TI is also appointed supplier of Trentino NGN for construction, management and operation of the network. The type of network to be deployed is the so-called point-to-multipoint which is the network of choice of the incumbents around Europe. No unbundling or access obligations are foreseen at this stage. The chosen architecture only foresees the rollout of three parallel GPON networks<sup>2</sup>, two of which will be available for concession to other operators.

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<sup>1</sup> The current figures are those resulting from the third amendment to the shareholders' agreement, signed on 11 May 2012. The original figures were [...] million EUR as cash contribution and the annual rate was established in 7,5%.

<sup>2</sup> A type of technology allowing provision of Internet services on a point-to-multipoint basis. Operators interested to provide services would have to activate the full network using the GPON technology.

### 3. COMMENTS FROM THE PARTIES INVOLVED

#### 3.1. Allegations made by the complainants

##### 3.1.1. *The measure constitutes incompatible State aid*

- (12) The complainants, the three main Italian OLOs<sup>3</sup>, contend that the PAT did not make an investment at market conditions and that, instead, the intervention constitutes incompatible aid. According to the complainants, the project involves the use of state resources to the advantage of a private undertaking in a way that distorts competition in the markets for electronic communication services and does not respect the rules for compatibility of State aid in the broadband sector as enshrined in the Broadband Guidelines of 2009<sup>4</sup>.
- (13) First, the complainants observe that no in-depth analysis of the business case was carried out before the PAT decided to carry out the project. By PAT's own admission, the target areas are not "high profitability" areas, i.e. those in which a commercial operator would invest on its own initiative. Moreover, the PAT did not have elements to evaluate its expected profitability at the moment it decided to invest: there was no business plan, no predetermination of the parameters for the evaluation of TI's contributions, no calculation of expected costs or profitability etc. They conclude, thus, that the intervention by the PAT is not guided by the pursuit of profit – as a market investor would do – but by public interest objectives, which constitute the basis for a state aid intervention.
- (14) As regards the specific features of the project, the OLOs observe that the first contribution by TI is a regulated asset which the joint-venture could use on a contractual basis at the regulated prices as opposed to acquiring it as an equity contribution. Moreover, the first contribution covers the whole provincial territory and not just the areas of interest of the joint venture, thus resulting redundant for the needs of Trentino NGN. As regards the second contribution, the complainants remark that its object is not an *asset* but a non-compete obligation (the switch-off of the copper network) to shield the joint venture from the interim competition by the parallel copper infrastructure. If such value is based on the theoretical network replacement value<sup>5</sup>, it will likely be higher than the real value that the acquisition will bring to Trentino NGN. Therefore, in the complainants' views, the evaluation of the in-kind contribution runs a significant risk of overestimating TI's participation, constituting a further element of aid.
- (15) As regards TI's call option, the OLOs argue that it does not ensure an internal rate of return (IRR) in line with that expected by private market investors. For example, they argue that Italian investors evaluating fibre projects expect an IRR in the range 12–15%, as in the example of a parallel project planned by the

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<sup>3</sup> Other Licensed Operators, i.e. the operators competing with the incumbent telecommunication provider.

<sup>4</sup> *Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks*, OJ C 235, 30.9.2009, p.7.

<sup>5</sup> E.g. for LRIC cost models, as used by the Telecoms Regulators for the purpose of determining access prices on the incumbent's infrastructure.

Lombardia region to roll out FTTH which foresees IRRs between 12% and 15% for all non-Telco partners (Region, Vendors and Private Infrastructure funds). The issue is even more critical because there is no corresponding "put" option for the PAT, implying that the PAT bears all the risks in case the initiative proves unprofitable, while it passes fully to TI the upside of a possible success by limiting its prospective return to that fixed as remuneration for the Call Option.

- (16) Furthermore, the OLOs argue that the alleged State aid would be incompatible with the internal market, since it does not respect the conditions of the Broadband Guidelines for the deployment of NGA networks<sup>6</sup>: no detailed mapping validated through an adequate public consultation has been carried out; no tender has been used to select the beneficiary but the PAT chose its private partner TI disregarding the principles of open and non-discriminatory treatment of all competitors. For example, the OLOs state that they have been denied access to fundamental information necessary to develop a counter proposal and were only given the option to accept a design of the project already finalised and suiting TI's business model<sup>7</sup>. Moreover, the measure does not respect the principle of technological neutrality - the technology has been pre-determined in the one favoured by the incumbent operator – and does not foresee any access obligation, nor claw-back mechanism.

### 3.1.2. *Alleged market distortion*

- (17) In the complainants' view, the rollout of a subsidized fibre infrastructure will disrupt the investment plans by all other operators, since duplication of such infrastructure is not economically feasible nor desirable. Moreover, the fact that the subsidy is granted without respecting the guarantees of the Broadband Guidelines is liable, in itself, to alter the competitive dynamics in the market and may lead to the re-creation of the old monopolies in the new NGA area.
- (18) The OLOs contend that competition in the wholesale market would be distorted through a disproportionate valorisation of TI infrastructure and, furthermore, infrastructure competition would be disrupted: the Trentino project does not foresee any unbundling or access obligation and chooses a technological solution which will reduce competitors' access to mere *bitstream*<sup>8</sup>. The alternative option of using one of the spare GPON networks is a model based on high fixed costs which would be sustainable only by TI (thanks to higher market share, the fixed costs is spread over a higher number of potential users) and very unlikely that operators with smaller market shares will be able to adopt it.
- (19) As a result, TI's dominant position would be unduly reinforced as TI would be allowed to leverage its market power from copper to NGN, a retail market would be pre-empted at a very early stage of development, TI would get operating control while migration to fibre is not completed and TI would be automatically awarded contracts for the provision of ancillary services that

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<sup>6</sup> Paragraphs 51 and 79 of the Broadband Guidelines.

<sup>7</sup> The OLOs state that the PAT granted them a meeting on 7 February 2011 to discuss the PAT's intention, while on the following day the MoU with TI was already signed.

<sup>8</sup> I.e. wholesale broadband access as retailers of the incumbent.

could be offered also by third parties. Ultimately, consumer welfare will be hampered.

### 3.2. Position of the Italian authorities

- (20) The Italian authorities claim that their action as regards Trentino NGN has the characteristics of an investment which a Market Economy Investor would have made. Therefore, it falls outside the scope of art. 107 (1) and does not require a notification to or an authorisation by the Commission to be carried out.
- (21) In support of their claim the Italian authorities have submitted the Business Plan prepared in the second half of 2011 as well as a due diligence report prepared by their consultant, an expert report on the value of the first in-kind contribution by TI and an expert opinion on the applicability of the Market Economy Investor Principle (MEIP) to their project. Their arguments can be summarised as follows.
- (22) First of all, the scope of action by the joint venture Trentino NGN covers only areas of the provincial territory in which, according to the PAT's own initial feasibility study, market initiative is possible under certain conditions including, *inter alia*:
- the maximisation of use of existing passive infrastructure (including not only telecommunications but also public lighting, highways, energy infrastructures etc.) to reduce deployment time and costs and to accelerate rollout;
  - the choice of the point-to-multipoint topology which allows considerable costs savings, also in the light of the weight of civil works in such projects (in a “brownfield” scenario which takes into account the civil infrastructure present in the provincial territory);
  - the switch off of the copper network in the medium run, which will move customers and revenues onto the new network.
- (23) The fact that the target areas are of “medium profitability” means, in the Italian authorities’ view, that there is an assured margin for a Market Economy Investor but which, for reasons *unrelated* to the absence of returns and due to the choices of the existing telecommunication operators, is not sufficient to generate spontaneous infrastructural competition and hence the deployment of an NGN network<sup>9</sup>.
- (24) In light of the initial assumptions concerning infrastructure costs for the roll out of optical fibre in the different geographic areas, the PAT initiated a verification of the existence of the conditions for the negotiation of an investment initiative with MEIP characteristics with potentially interested operators, in search of a business plan who could guarantee an adequate economic return. TI showed its interest immediately and in line with the lines of intervention devised by the PAT in its initial assessment. For this reason the MoU with TI could be signed

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<sup>9</sup> First reply by the PAT of July 2011.

already in February 2011. Nevertheless, the PAT continued its negotiations with other potentially interested parties and assessed their proposals for participation to the joint venture, as a market economy investor would do. And indeed two more private partners emerged: McLink and Finanziaria Trentina.

- (25) In the Italian authorities' view, the three OLOs, complainants in the present case, did not show a real interest, since they did not make an offer in line with the request of the PAT regarding coverage objectives (well below 60%), only proposed expensive technological solutions (only point-to-point technology was indicated with unbundling at the local exchange), and proposed other characteristics which would jeopardize the PAT's interest in establishing a sustainable business plan for the project. The PAT concluded that the OLO's interest was that of opposing the MoU with TI rather than proposing a suitable alternative<sup>10</sup>.
- (26) To support their claim that the Trentino NGN project, as results at the end of the negotiations among the participating partners, is a sustainable business, the Italian authorities submitted a due diligence report on the business plan<sup>11</sup> concluding that the project has an internal rate of return of about [*between 7 and 12%*] which makes it profitable on market terms.
- (27) Secondly, as regards TI's participation, in the MEIP spirit the PAT never had any interest to reduce the investment risk for the main private partner of the joint venture. Instead, it was always the PAT's intention to involve private partners in the project, proportionally to their size and contributing with resources (financial or otherwise) with full assumption of their entrepreneurial risk. Therefore, for the evaluation of TI's contributions, the PAT had since the beginning the intention to assess them in respect of their actual value and to exclude any advantage for the private partner. In this regard, a specific expert report was foreseen since the beginning for each of the contribution.
- (28) The first expert report is already available and substantially confirms the estimated value of the first of TI's contributions with just a minor difference, which was promptly reflected in a modification of the shareholders' agreement. The Italian authorities expect to save up to [...] million EUR thanks to the reuse of TI infrastructure in the medium-profitability areas and to reduce significantly the time to market and operating expenditure (OPEX)<sup>12</sup>.
- (29) As regards the second contribution, the Italian authorities state that the value of [*between 480 and 560*] EUR per active line is the result of the negotiation between the parties starting from the value of capital invested (for ULL line) for the reconstruction of the access network as can be determined by the National Regulatory Authority (AGCOM) model to calculate the ULL price adjusted by the return on invested capital of [...]%. It is a calculation on a national average value. The value of TI's second contribution for Trentino NGN is very high because it gives the joint venture the possibility to actively control the migration from copper to fibre.

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<sup>10</sup> As reported in the email submission of 13 April 2012.

<sup>11</sup> Due diligence report by Analysys Mason, as presented at the meeting of February 2012.

<sup>12</sup> PAT's Presentation of 23 February 2012.



- (30) Thirdly, as regards the call option in favour of TI, the Italian authorities contend that the fees originally foreseen to be paid by TI for the exercise of the option<sup>13</sup> already made the return for the PAT in line with the return on equity (ROE) of businesses engaging in similar infrastructure projects. To show this, the Italian authorities referred to the results of the 6 “most representative companies” in the FTSE All-Share Italy Utilities Index (IT7500)<sup>14</sup>. Nevertheless, after discussions with the Commission and after an expert report by Eupragma and Analysys Mason<sup>15</sup>, the parties agreed to a further increase in the fees as explained above in paragraph (11) making the expected return for the PAT amounting to an overall [*between 7 and 12%*]<sup>16</sup> in case TI decides to exercise the option, which is considered in line with MEIP. No put option has been foreseen for the PAT, differently from the other minor private shareholders: in the PAT’s view, this could have resulted in the PAT’s participation being considered a long term loan, which would, in their view, be incompatible with the MEIP approach<sup>17</sup>.
- (31) Lastly, as regard the technological choice of three overlapping GPON, the PAT contends that the choice was made initially solely on the basis of its lower cost and convenience. Such technological choice was later embraced by the private partners who joined the project. From a private investor point of view, the PAT always declared itself open to extend, subject to contribution of the corresponding amount, the availability of P2P connections to more customers than those currently estimated as economically convenient (industrial areas for example).

### **3.3. Position of the Italian National Regulatory Authority - AGCOM**

- (32) On the basis of the documents submitted to the Commission, it emerges that the PAT informed AGCOM of its intention concerning Trentino NGN and submitted to its attention the shareholders’ agreement with the private partners. AGCOM’s comments limited themselves to observing that the measure was not in conflict with existing regulation, except in the part in which the company Trentino NGN, after acquiring TI’s passive infrastructure (ducts), could refuse access to third parties whenever the available duct space was necessary to achieve its fibre rollout plans. AGCOM observed that in no way TI’s regulatory obligations as regards its passive infrastructure could be waived by means of a contractual agreement with Trentino NGN. Following AGCOM’s remarks, the shareholders’ agreement was amended accordingly.

## **4. ASSESSMENT OF THE MEASURE**

- (33) 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*

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<sup>13</sup> I.e. [...] million EUR plus 7,5% annual return.

<sup>14</sup> The Index includes mostly energy companies.

<sup>15</sup> Submission of May 2012

<sup>16</sup> The fair value of the option was calculated using the Black and Scholes model.

<sup>17</sup> Email exchange of 13 April 2012.

*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, 4) it has to distort or threaten to distort competition and has to be liable to affect trade between Member States.

#### **4.1. Existence of aid**

##### *4.1.1. State resources*

- (34) The resources indicated in the description of the measure, consisting of equity contribution by the PAT to the joint-venture Trentino NGN, clearly constitute State resources, as they come from the budget of a (local) public authority.

##### *4.1.2. Advantage*

- (35) It needs to be assessed whether the investment by the PAT in the company Trentino NGN constitutes an advantage within the meaning of article 107(1) TFUE.
- (36) According to the case law of the European Courts, the principle of equal treatment implies that capital placed by the State, directly or indirectly, at the disposal of an undertaking in circumstances which correspond to normal market conditions cannot be regarded as granting an advantage, and therefore a State aid, within the meaning of Article 107(1) TFEU. When equity participation or capital injections by a public investor do not present sufficient prospects of profitability, even in the long term, such intervention must be regarded as granting an advantage within the meaning of Article 107 TFEU.
- (37) In its Amsterdam decision<sup>18</sup>, the Commission has examined the application of the MEIP in the broadband field. As underlined in this decision, the conformity of a public investment with market terms has to be demonstrated thoroughly and comprehensively, either by means of a significant participation of private investors or the existence of a sound business plan showing an adequate return on investment. Where private investors take part in the project, to exclude the presence of State aid, they would have to assume the commercial risk linked to the investment under the same terms and conditions as the public investor.
- (38) The PAT's project has several features which at this point lead to doubts as regards its compliance with the MEIP.

##### *The timing of the project*

- (39) In general terms if the PAT is acting as a market investor, it will not be guided by common interest objectives (Digital Agenda, cohesion, etc.) and its project would have to be profitable in itself and for the public partner specifically.

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<sup>18</sup> Commission Decision of 11 December 2007 in case C 53/2006 – The Netherlands, Citynet Amsterdam - Investment by the city of Amsterdam in a fibre-to-the home (FttH) network, OJ L 247, 16.9.2008, p.27

Taking the perspective of a financial investor, as the PAT could be considered, in light of the previous considerations, a market economy investor would check the minimum return it could expect for an investment into an NGA network in this region (on the basis of specific risks of such NGA investment), would compare it with alternative investments and, if it turns out that investing in a NGA network is indeed a profitable enterprise, what is the best way to achieve the result sought.

- (40) It is important to recall that, as restated by the European Court in the EDF judgment<sup>19</sup>, to prove that the State acts as a market economy investor, it is not enough to rely on economic evaluations made after the advantage was conferred, on a retrospective finding that the investment made by the Member State concerned was actually profitable, or on subsequent justifications of the course of action actually chosen.
- (41) In consideration of the timing of the various steps in the project (the MoU, the contacts with the operators, the redaction of the business plans etc.) and on the basis of the public statements and deliberations made by the PAT, there are doubts that the public authority acted as a market economy investor.
- (42) The PAT itself acknowledges that the areas targeted by the project are of "medium profitability", i.e. areas in which private operators have not declared an intention to invest in NGA. If the PAT itself admits that the targeted areas are of no interest for a private investor, it is contradictory to claim that the project as a whole was conceived as a MEIP investment. During the course of the contacts with the Commission, the PAT stated that such areas are of no interest to private investors for reasons "*unrelated* to the absence of returns and due to the choices of the existing telecommunication operators". It still has to be clarified what are such reasons unrelated to profit which discourage private investors.
- (43) In other words, at this stage it cannot be excluded that the public authority deliberated to invest into NGA deployment out of the public interest to bring ultra-fast internet to the citizens of its territory because private investment was not commercially viable; then, it chose to create a Public-Private Partnership with the incumbent and only *ex post* did the PAT attempt to make the project compliant with the MEIP, making changes, *inter alia*, following discussions with the Commission, while keeping the structure of their initiative unaltered.

*The significant participation of private parties*

- (44) When there are other investors in a project together with the public authority, it has to be verified whether they are private investors and whether their participation is of real economic significance. While formally the PAT has found three private parties to join the company Trentino NGN, two of those shareholders have a very limited participation to the project, since it is limited

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<sup>19</sup> Case C 124/10P, European Commission v EDF, Judgment of 5 June 2012, paragraph 85.

to small financial contributions<sup>20</sup>. The participation of those two shareholders in the project could therefore be considered negligible. Conversely, TI is a private partner in Trentino NGN having a significant participation. It is therefore important to verify whether the position of the public authority is comparable to that of the private partner or, in any event, that the public authority receives adequate return on its investment comparable to that of a private investor in the same situation.

#### Concomitance of the investment

- (45) For the MEIP to be fulfilled in presence of private investors in the same project, it has to be assessed whether the private and the public partners' investment are concomitant. From the analysis of the Trentino NGN shareholders' agreement, there are doubts that concomitance exists in the investments of the public partner and the private one<sup>21</sup>. Formally speaking, the PAT committed its contribution at the moment of the first Provincial Council deliberation. Therefore, potential private investors already knew that there would be an investment by the public authority, a factor which already at this stage could play a role in the private investors' subsequent decision to invest in the area and in the specific project and thus exclude the concomitance in the investments.
- (46) In any event, there is another discrepancy in the positions of the public and the private partners. The PAT completed its financial contribution to the joint-venture Trentino NGN in its entirety at the moment of the first equity capital increase on 18 May 2012, i.e. at the moment the company came into being in its operational form. Conversely, at the time of the PAT's investment, TI makes only the first of its in-kind contributions, limited to the long-term lease of its existing passive infrastructure. The second contribution is due only later, as of the end of the 3rd year from the first contribution or as of the activation of at least [*between 14 and 21%*] of the new fibre connections. Moreover, it is conditional to the decision to initiate it by either TI or the PAT<sup>22</sup>.
- (47) Under such circumstances it cannot be concluded that the participations of the public partner and the private one are concomitant.

#### Same terms and conditions

- (48) Furthermore, it has to be identified whether the terms and conditions of the investment are identical between the public and private partners.
- (49) On the basis of the information submitted to the Commission, there are serious doubts that the terms and conditions at which the public authority is investing in the joint venture are the same as those of the private partners. Leaving aside the position of the two small shareholders, whose contribution to Trentino NGN cannot be considered significant, the following analysis concentrates on the

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<sup>20</sup> For one of them, the complainant raised doubts as to its true "private" nature, while the PAT denied any public interest in the company. In any event, since the participation is of limited significance, it does not seem necessary at this stage to investigate the point.

<sup>21</sup> The two minor shareholders' participations being of limited significance, the relevant analysis needs to be applied to TI's position.

<sup>22</sup> In the original shareholders' agreement, only TI could decide to initiate the second contribution.

terms and conditions at which TI participates to the company and on whether there are no advantages granted to it.

- (50) In fact, there are *prima facie* several discrepancies between the PAT's and TI's positions in the joint venture.
- (51) First, as mentioned already above in paragraph (11), TI does not make the whole contribution to Trentino NGN at the same time as the PAT and TI's contribution is conditional to one of the parties requesting it. Secondly, the position as shareholder of the joint venture is different for the private and the public partners: in the first phase of the project the PAT is the controlling shareholder while TI has a minority shareholding. The respective positions are reversed in the second phase when the second contribution takes place and the control will pass to TI, if necessary adding a financial contribution to the contribution in kind. Finally, TI enjoys the possibility of acquiring the PAT's share and gain full control of Trentino NGN via the call option. Therefore, the terms and conditions of the respective positions do not seem to be comparable, as the PAT and TI seem to pursue different investment objectives.
- (52) Moreover, as regards the actual contributions to the joint venture, they are different in nature: TI commits to Trentino NGN only in-kind assets whilst the PAT makes a financial contribution. TI's existing infrastructures are certainly a valuable asset for a company entering the (ultra-fast) broadband markets. However, to exclude an advantage in favour of TI, such contributions must be accepted by the public partner at the same conditions as a market economy investor would.
- (53) As regards the first of its contribution, TI grants to Trentino NGN a long term lease (IRU) on duct space and on poles of the existing network in the whole territory of the province. As mentioned above, the expert report prepared for the PAT substantially confirms the evaluation made in the shareholders' agreement using the methodology of the Unlevered Discounted Cash Flow. The expert report by Ernst & Young is expressly based on the data and information contained in the documents and business plan prepared by the parties to the joint venture and therefore relies on the assumptions, forecasts and financial analyses made by the parties, without verifying them.
- (54) Nevertheless, even without questioning the value of the contribution, it is not clear whether a private investor would accept that access to a regulated asset – which could be obtained by contractual means at the regulated prices – is rewarded by a rather significant equity participation to the joint venture. There are doubts also that a market economy investor would accept as equity participation the lease of the infrastructure which will be acquired as ownership at a later stage. On the other hand, the scope of the first contribution appears to be oversized as compared to the actual needs of Trentino NGN, since the object of the IRUs is TI's ducts and poles space in the *whole* provincial territory and not limited just to the areas in which Trentino NGN will deploy its network (i.e. the areas of medium profitability) and therefore has an interest to access TI's ducts and poles.

- (55) Regarding the second contribution, which is due only at a later stage, at the moment there is only a negotiated methodology of evaluation and no expert opinion, which, pursuant to the agreements, will be requested only at the moment when the contribution is due. The second contribution consists of two parts: (i) the conversion in ownership of the IRUs (which constitute the object of the first contribution) on TI's ducts space *only* in the areas of medium profitability of the Province (i.e. the target areas of Trentino NGN<sup>23</sup> and (ii) the transfer of the ownership of all the components of the copper network, with a perspective to switching it off after migrating all customers on the new fibre network.
- (56) The part *sub* (i) has been contractually established in [...] million EUR corresponding to the value of the IRUs for [...] years. On the basis of the information submitted by the Italian authorities, there are still doubts that this evaluation is in conformity to market terms, in particular whether any overlaps in the evaluation of the first (lease) and the second (ownership) contributions are avoided, given that for most part, the rights conferred have the same object.
- (57) As regards the part *sub* (ii), the importance of this contribution lies in the fact that the copper network may be switched off once the fibre network becomes operational and thus will not exercise a competitive constraint on the future fibre network of Trentino NGN. There is still, indeed, substitutability between the connectivity services which can already be offered on the copper network and those which are possible on a fibre one. The potentialities of the copper network can be further increased thanks to technological developments<sup>24</sup>, prolonging its ability to generate revenues and thus its life. In other words, the switch-off of the copper network is an asset contributing to the success and profitability of a project to rollout a fibre network and therefore from a market economy investor perspective, *prima facie* it makes sense to agree with the owner of the copper network to switch it off and migrate the customers on the new fibre network.
- (58) However, at the same time, the copper network has a number of other characteristics which complicate its evaluation: it is indeed difficult to precisely evaluate its future lifetime and hence its residual value; moreover it has very high maintenance costs, especially compared to a new, state-of-the-art fibre network.
- (59) In these circumstances, an assessment of the appropriateness of the methodology for the evaluation of the contribution is crucial to exclude any advantage in favour of the private partner.
- (60) The PAT and TI agreed that the value of the copper network is established in *[between 480 and 560]* EUR per active line, including the lines unbundled in favour of competing providers. The methodology used to establish such value is based on the average theoretical network replacement value, on the basis of the BU-LRIC model used by the Italian National Regulatory Authority AGCOM to

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<sup>23</sup> The first contribution, as mentioned above, covers ducts space in the whole provincial territory, beyond the target areas of Trentino NGN.

<sup>24</sup> For example the use of technologies such as vectoring or bonding.

determine the ULL fees<sup>25</sup>. This value is understood as the average value across the national territory and not specifically calculated for the provincial territory<sup>26</sup>.

- (61) At this stage, and on the basis of the information submitted to the Commission, there are still doubts that this methodology is the most appropriate one to exclude advantages for the private partner. Several other possible methods could be used and are being considered in different contexts to assess the value of the copper infrastructure and which give very different results. For example using the method of the accounting value of the network or using as a basis the expected ULL cash flows for the duration of the project, net of the maintenance costs, would give substantially lower values than the one agreed between PAT and TI.
- (62) In the light of the above, the terms and conditions applying to the public investor do not seem unequivocally comparable to those of the private partner in the joint venture and thus the existence of an advantage in favour of TI cannot be excluded.

*Analysis of the business plan and parties' level of risk*

- (63) In a MEIP project, it is expected that the public partner does not take up risks which are not adequately compensated by the expected returns on its investment.
- (64) As regards the parties' level of risk in the enterprise, there are *prima facie* significant differences between the public authority and the private investor. Given the different nature of the parties' contribution, financial for the PAT and in kind for TI, and the different rights and obligations of the parties, they do not seem *prima facie* to share risks the same way.
- (65) From TI's perspective the investment in Trentino NGN does not seem to imply *prima facie* a very high risk: in the first phase TI confers to the company only the unused space in its existing infrastructures, without any additional investment and is rewarded with a significant share of the joint venture. In addition, TI will receive remuneration for building the new network. This arrangement makes the opportunity costs for TI very low: given that in the areas of intervention no commercial investor had plans to rollout a fibre network in the near future, it is quite unlikely that the unused duct space transferred to Trentino NGN would have been requested by other operators. When in the second phase TI contributes to the company the whole copper network, by the same token it will acquire control of the joint venture, hence will retain the control over the physical assets just conferred to Trentino NGN – as well as over the newly built fibre network. Moreover, TI will continue to run its core business, i.e. that of providing telecommunication services, on behalf of Trentino NGN. Finally, thanks to the existence of the call option, if the enterprise turns out to be very profitable, TI may decide to exercise the option and obtain full control of Trentino NGN and full internalisation of the profits.

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<sup>25</sup> Shareholders' agreements, Annex G.

<sup>26</sup> The Italian authorities suggested that such value would be even higher if the local difficult geographical conditions would be taken into account.

Conversely, should the investment turn out less profitable than expected, TI would still have the possibility not to exercise the option and thus be able to share the losses of the project with the public partner who has no exit option (because there is no “put” option).

- (66) From the PAT’s perspective, the scenario changes quite substantially. The PAT immediately invests its financial resources into the joint venture and thus since the beginning it faces the full risk of the operation not being successful. In other words, the PAT seems to be acting as a financial investor into a project of infrastructure upgrade, expecting at most a return of [...] % and [...] million EUR if the call option is exercised (RoE of *[between 7 and 12%]* in the calculations made by the PAT). In fact, the existence of the call option in favour of TI caps the expected return for the PAT in case of success of the operation. In addition, the absence of a corresponding “put” option to exit from the joint venture in case of failure of the project (available instead to the other minor private shareholders), leaves the public authority exposed to losses in case of failure of the project, in which case it is reasonable to expect that TI would not exercise the call option.
- (67) The just highlighted significant differences in the respective positions of the PAT and TI imply that the remuneration for the respective investments of the public authority and the private partner would also have to reflect the difference in the risks. On the basis of the information available to the Commission, there are serious doubts that this is the case.
- (68) According to the Trentino NGN business plan submitted by the Italian authorities, the project has an IRR of *[between 7 and 12%]* and thus the operation constitutes a profitable enterprise. Taking the calculation of the business plan at face value, this is supposedly the remuneration which the parties expect from their investments, with the PAT maximum remuneration capped anyway at *[between 7 and 12%]*<sup>27</sup>. In the basic case scenario, therefore, the remunerations of the public authority and of the private partner would therefore not be different despite the significant difference in the respective investment risks as highlighted above. In addition, if TI exercises its call option, while the remuneration of the PAT is capped, the returns for TI could be even higher.
- (69) A Some doubts that the public authority’s remuneration may not be adequate vis-à-vis the level of risks taken, could be raised in the light of the submission by the complainants that for a project with similar characteristics and levels of risk as the PAT, a higher RoE would be required, i.e. of at least 12% and up to 15%<sup>28</sup>.
- (70) Additionally, there are indications that the calculations in the business plan may not be entirely accurate. Already the due diligence by Analysys Mason highlighted certain too optimistic assumptions regarding the actual demand by end users and about the revenues from alternative operators activating *all* the

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<sup>27</sup> Submission of 13 May 2012

<sup>28</sup> Demanded by Regione Lombardia in the context of its negotiation with TI for a similar project.



PON lines available<sup>29</sup> – before concluding that the expected IRR was lower than the one originally calculated by the parties but still acceptable to a market economy investor (i.e. [...] % instead of [...] %).

- (71) Besides the risks already highlighted by the PAT's consultant, there are other factors which may influence the profitability of the enterprise, for example:
- The copper network may still maintain a significant appeal for TI in view of the revenues it gets on the legacy infrastructure. In such case, TI may decide to postpone the switch off of the legacy network, without any contractual provision which makes it obligatory. This event would greatly delay the break even point for Trentino NGN.
  - The total financial resources necessary to complete the network rollout are quantified in 165 million EUR and it is not clear where these resources are expected to come from.
- (72) On the basis of the above remarks, at this stage the Commission has serious doubts that the assumptions of the business plan are adequate and that the expected return on investment for the parties has been adequately determined.

#### Other relationships

- (73) Further to the above, there are other relationships which have been established with specific separate agreement between Trentino NGN and TI. In particular, TI will not only be the private partner of the joint venture but will also be the supplier of services for Trentino NGN, in particular construction services, maintenance, provision of connectivity to the end users) thereby receiving a fee for the services provided. The PAT argues that such services will be provided by TI either at regulated prices (whenever such prices exist) or at market prices. However, TI has not been chosen as provider via an open selection procedure which would have reassured that the level of prices charged for the level of service offered are indeed not higher than the market prices.
- (74) Moreover, given its dual position of shareholder and supplier of Trentino NGN, it cannot be excluded that there are other hidden indirect advantages accruing to TI.
- (75) On the basis of all the elements exposed in this section, the Commission has serious doubts that the public intervention in this project is in line with the market economy investor principle and does not confer an advantage to Trentino NGN and its private shareholders in the sense of Art. 107 (1).

#### *4.1.3. Selectivity*

- (76) As indicated, if the project under assessment is not in line with the MEIP, an economic advantage may exist in favour of Trentino NGN and its private

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<sup>29</sup> As mentioned above, there are 3 parallel GPON networks which are foreseen to be rolled out, two of them redundant to the needs of Trentino NGN and in theory destined to be leased for operation by alternative providers.

shareholders. In fact, when public funds go to the rollout of a broadband network in areas in which *prima facie* a private operator would not otherwise invest, the selected operator will be able to provide broadband services at conditions not otherwise available on the market. The aid could allow the operator to offer end-to-end services at lower prices than if it had to bear all costs itself and thus attract more customers than under normal market conditions.

- (77) Such advantage, would have a selective character, as it benefits clearly identified undertakings.

#### *4.1.4. Distortion of competition and effect on trade between Member States*

- (78) The markets for electronic communications services are open to competition (both at wholesale and at retail level) between operators and service providers, which generally engage in activities that are subject to trade between Member States.

- (79) The intervention of the State alters existing market conditions by allowing the provision of enhanced wholesale broadband services by the selected electronic communication operator and third party providers that would not be available under normal market conditions. The measure is therefore likely to alter the conditions of competition between Trentino NGN and TI and other EU wholesale and retail operators.

#### *4.1.5. Conclusion*

- (80) In view of the above, the Commission has at this stage serious doubts whether the Italian measure is in line with the Market Economy Investor Principle. The Commission doubts whether all parties actually invest under the same terms and conditions and whether the PAT does not accept to take on certain risks alone without appropriate compensation for these risks. In case the measure does not meet the Market Economy Investor Principle, an economic advantage may be granted through public funds to Trentino NGN and its shareholders. The project has a selective character and can distort competition and affect trade between Member States. Therefore, at this stage and based on its preliminary assessment, the Commission considers, at this stage, that the notified measure could include elements of State aid within the meaning of Article 107(1) TFEU.

#### *4.1.6. Lawfulness of the aid*

- (81) If the presence of State aid is confirmed, since the measure has not been notified, the aid would be unlawful. The compatibility of the aid would still need to be assessed.

## **4.2. Compatibility of the aid**

- (82) The Italian authorities have argued that the present project does not involve State aid. They did not put forward arguments to show that any State aid element possibly present would be compatible with the Treaty and have not submitted any evidence in that respect.

- (83) The compatibility of any State aid granted through that project would normally have to be assessed according to Article 107 (3) (c) TFEU and the *Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks*<sup>30</sup>. As regards the applicable substantive provisions, the Commission has essentially to analyse the measure in the light of the criteria developed in particular in paragraphs 31-79 of the Broadband Guidelines.
- (84) As regards those criteria, the Commission recognises that the *objectives* of the measure, if involving aid, could be considered in line with the policy of the EU and especially its Europe 2020 strategy of 3 March 2010<sup>31</sup> and the Flagship Initiative: "A Digital Agenda for Europe", which has the "*aim to deliver sustainable economic and social benefits from a Digital Single Market based on fast and ultra fast internet and interoperable applications, with broadband access for all by 2013, access for all to much higher internet speeds (30 Mbps or above) by 2020, and 50% or more of European households subscribing to internet connections above 100 Mbps.*" The Italian authorities have submitted information on the positive economic development aspects of the measure and the potential benefits of the measure for the citizens. The Italian measure, therefore, could facilitate and encourage investments in NGA (last mile) networks, in line with the objectives of the Broadband Guidelines and the Digital Agenda.
- (85) However, as regards the *design of the measure* and the need to *limit distortions* of competition, the Italian authorities do not seem to have designed the measure in such a way as to minimise the State aid involved and the potential distortions of competition arising from the measure and have not put forward the necessary evidence to prove the compliance with the conditions set in the Broadband Guidelines.
- (86) As set out in paragraphs 51 and 79 of the Broadband Guidelines, in assessing the proportional character of the notified measure in "white NGA areas" a number of conditions has to be met in order to minimise the State aid involved and the potential distortions.
- (87) Should the presence of aid be proved, the Italian authorities would have to prove that their market research and public consultation were adequately conducted in order to fulfil the condition of the Broadband Guidelines concerning a *detailed mapping and coverage analysis*<sup>32</sup>. Moreover, the Italian authorities would have to show that they did not contravene the condition of the Guidelines concerning an *open tender* process<sup>33</sup>.
- (88) While the use of existing infrastructure seems at the core of the Italian measure, as regards the choice of deploying a specific (GPON) technology, further

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<sup>30</sup> OJ C 235 of 30.9.2009, p. 7.

<sup>31</sup> EUROPE 2020 - A strategy for smart, sustainable and inclusive growth, COM(2010) 2020, page 12.

<sup>32</sup> See point 51(a) of the Guidelines.

<sup>33</sup> See point 51(b) of the Guidelines.

investigation may be warranted to ensure the respect of the condition of the Guidelines concerning technological neutrality<sup>34</sup>.

- (89) Additionally, at this stage of analysis, the Commission has doubts that the project complies with the condition of the Guidelines concerning the grant of wholesale access<sup>35</sup> (in particular, with regard to unbundled access), which is a crucial element to find that an aid measure to broadband networks does not distort competition to an unacceptable extent<sup>36</sup>.
- (90) Finally, the condition concerning a claw back mechanism does not seem to be fulfilled<sup>37</sup>.
- (91) For those reasons, the Commission has therefore serious doubts concerning the compatibility with the internal market of any State aid element involved in the project.

## 5. CONCLUSION

- (92) In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) TFEU, requests the Italian Republic to submit its comments and to provide all such information as may help to assess the measures under consideration.
- (93) The Commission requests your authorities to forward a copy of this letter to the potential recipients of the aid immediately.
- (94) The Commission wishes to remind the Italian Republic that Article 108(3) TFEU has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.
- (95) The Commission warns the Italian Republic that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the Official Journal of the European Union and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

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<sup>34</sup> See point 51(d) of the Guidelines.

<sup>35</sup> See point 51(f) of the Guidelines.

<sup>36</sup> In this respect, the Commission also notes that, while the design of the project foresees the rollout of three overlapping GPON networks, two of them redundant to the needs of Trentino NGN and in theory destined to fulfil potential requests by other operators, it is highly unlikely that there will be OLOs ready to invest in such project, as recognised also in the documents submitted by the Italian authorities (see the due diligence plan by Analysys Mason), considering that (i) the GPON technology is not compatible with the technological choices of the majority of the OLOs and (ii) the activation of a full GPON network requires a number of connected users higher than what an OLO has, in particular in the Trentino territory.

<sup>37</sup> See point 51(h) of the Guidelines.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. In that respect, where figures or information portrayed in this decision are deemed to be confidential, the Italian authorities are requested to provide a range indicating the order of magnitude concerned (e.g. between X and Y EUR million, between X and Y %) and/or to limit deletions to sentences or phrases which are confidential.

If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission  
Directorate-General for Competition  
State Aid Greffe  
Rue Joseph II 70  
B-1049 Brussels  
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Yours faithfully,

For the Commission

*Joaquin ALMUNIA*

Vice-President