

EXPLANATORY MEMORANDUM

NOTE: This explanatory memorandum gives an overview of the current rules and the relevant Commission decision-making practice. It also outlines the possible scope for amendments to the Broadcasting Communication. It provides useful background information in relation to the questions listed in the consultation questionnaire. This explanatory memorandum and the questionnaire follow the same numbering and each section of the memorandum is to be understood as an introduction to the corresponding section of the questionnaire.

1. GENERAL

The financing of public service broadcasters is subject to the rules of the EC Treaty on State aid. The Treaty recognises the special importance of service of general economic interest and allows for the funding of public service broadcasting under certain conditions. In particular as regards public service broadcasting, Member States have agreed in the context of the Amsterdam Treaty on a Protocol on the system of public broadcasting in the Member States (hereafter: "Amsterdam Protocol"). In the Amsterdam Protocol, Member States considered *"that the system of public broadcasting in the Member States is directly related to the democratic, social and cultural needs of each society and to the need to preserve media pluralism"* and agreed upon the following interpretative provisions: *"The provisions of the Treaty establishing the European Community shall be without prejudice to the competence of Member States to provide for the funding of public service broadcasting insofar as such funding is granted to broadcasting organisations for the fulfilment of the public service remit as conferred, defined and organised by each Member State, and insofar as such funding does not affect trading conditions and competition in the Community to an extent which would be contrary to the common interest, while the realisation of the remit of that public service shall be taken into account."*

The Broadcasting Communication adopted in 2001 enshrines the basic principles and requirements for analysing the funding of public service broadcasters within the legal framework described above. Since 2001, the Commission decision-making practice, the legal framework governing the activities of public service broadcasters as well as markets have evolved. This consultation provides an opportunity for stakeholders and Member States to express their views on the appropriateness and scope of possible amendments to the Broadcasting Communication in the light of these developments. This consultation will help the Commission to get a better understanding of future developments and challenges for the audiovisual media sector and to analyse the possible implications for the assessment of State aid to public service broadcasters.

2. COMPATIBILITY ASSESSMENT - ARTICLE 86 (2) EC TREATY AND THE BROADCASTING COMMUNICATION

2.1. Coherence with the Commission Decision and Framework on public service compensation¹

In 2005, and as announced in the White paper on services of general economic interest², the Commission adopted a Decision and a Framework laying down the conditions under which public service compensation payments are or can be regarded as compatible with the common market, and in particular Article 86 (2) EC Treaty. The aim was to increase legal certainty and to cut the administrative burden on Member States, because fewer cases concerning the financing of public services would need to be notified to the Commission.³ These conditions only apply to the financing of public service broadcasters to the extent that the funding and the public service broadcaster's turnover remain below certain thresholds.⁴ In practice therefore, the Decision is applicable mostly to small and/or regional or local public service broadcasters.

The Decision and the Framework contain a number of elements which are not mentioned in the current Broadcasting Communication. These elements concern, for instance, the invitation to Member States to define the public service remit after wide consultations⁵ and in particular the rules governing (over-) compensation. These rules require that the act of entrustment contains the parameters for calculating the compensation amount as well as arrangements for avoiding and repaying any overcompensation⁶. The permissible amount of compensation may include a reasonable profit, which may include some productivity gains⁷. There are also more detailed rules regarding cost allocation and in particular the requirement of separate accounts⁸, not only distinguishing between public service and other activities, but also distinguishing between separate public service obligations (i.e. activities which are different in nature)⁹. Further rules include the

¹ Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ L 312 of 29 November 2005) and Community framework for State aid in the form of public service compensation, (OJ C 297 of 29 November 2005).

² Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - White Paper on services of general interest (COM/2004/0374 final of 12.5.2004): http://eur-lex.europa.eu/LexUriServ/site/en/com/2004/com2004_0374en01.pdf

³ Cf. also speech of Commissioner Kroes in the context of the press conference given in relation to the adoption of these measures in July 2005 (SPEECH/05/447).

⁴ Cf. Article 2 (1)(a) of the Decision. It is recalled that the Framework explicitly excludes public service broadcasting from the scope of application (cf. paragraph 3 of the Framework).

⁵ Cf. paragraph 10 of the Framework.

⁶ Cf. Article 4 (d) and (e) of the Decision as well as paragraph 12 of the Framework.

⁷ Cf. Article 5 (1) of the Decision as well as paragraph 14 of the Framework.

⁸ Cf. Article 5 of the Decision as well as for instance paragraph 16/17 of the Framework.

⁹ Cf. paragraph 19 of the Framework.

requirement to have regular checks on overcompensation and the obligation to adapt the parameters for the determination of the adequate compensation amount in light of past performance¹⁰ and the possibility for the public service provider to keep, under certain conditions, a certain margin at the end of any financial year (expressed as 10% of the amount of annual compensation),¹¹ but also the requirement for any surplus to be repaid to the State at the end of any particular funding period, but not exceeding 4 years.¹²

Some of the above elements could be included in a revised Broadcasting Communication to provide additional clarification of the interpretation of the basic requirements laid down in Article 86 (2) EC Treaty. However, there may be certain specific requirements which could call for adaptations in light of the specificities of the funding mechanisms for public service broadcasters or the application of which to public service broadcasting might be inappropriate. The Commission services invite stakeholders and Member States to express their views in this respect.

2.2. Definition of the public service remit

Paragraphs 32 – 39 of the Broadcasting Communication set out what the Commission examines as regards the public service remit defined by Member States. The Broadcasting Communication accepts a wide remit, in view of the interpretative provisions of the Amsterdam Protocol, covering a varied and balanced programme and also states that “...services that are not ‘programmes’ in the traditional sense, such as on-line information services” could be part of the remit, provided that they serve the same democratic, social and cultural needs of society. In principle, the definition of the public service mandate falls within the competence of the Member States. However, the Broadcasting Communication requires them to define the remit clearly, leaving no doubt as to whether or not a certain activity is part of the remit. This is important for the sake of allowing third parties to plan their activities and enabling national control bodies to check the fulfilment of the public service tasks. Furthermore, the Commission needs to check for manifest errors in the definition. According to the Broadcasting Communication, examples of activities which cannot normally be viewed as part of the public service remit are advertising and e-commerce.

The markets for delivery of audiovisual content have evolved significantly since 2001, with the emergence of digital terrestrial television, the Internet and mobile devices, as well as the creation of new offers such as thematic channels and other services. The Broadcasting Communication recognises that activities other than TV programmes in the traditional sense can be included in the public service remit, to the extent that while taking into account the development and diversification of activities in the digital age, they are addressing the same democratic, social and cultural needs of the society in question. However, the Broadcasting Communication does not specify how to assess this and how the Commission can exercise its task to check for manifest errors in the definition.

¹⁰ Cf. Article 6 of the Decision and paragraph 20 of the Framework.

¹¹ Cf. Article 6 (2) of the Decision and paragraph 21 of the Framework.

¹² Cf. paragraph 21 of the Framework.

In its decision concerning the financing of public service broadcasters in Germany, the Commission was satisfied that the determination of whether new media activities satisfy the same democratic, social and cultural needs of society is based on a set of criteria suitable to assess the public service character of the service in question also in light of other already available offers on the market.¹³

The recently adopted Audiovisual Media Services Directive takes account of the above market and technological developments by extending the scope of the EU audiovisual regulation to some new media services. "Television broadcasting (i.e. "a linear audiovisual media service") is defined as "...an audiovisual media service provided by a media service provider for simultaneous viewing of programmes on the basis of a programme schedule." On the other hand, "on-demand audiovisual media service" (i.e. a non-linear audiovisual media service") is defined as "...an audiovisual media service provided by a media service provider for the viewing of programmes at the moment chosen by the user and at his individual request on the basis of a catalogue of programmes selected by the media service provider." Both services are "audiovisual media services" defined as "...a service ... which is under the editorial responsibility of a media service provider and the principal purpose of which is the provision of programmes in order to inform, entertain or educate, to the general public by electronic communications networks ...".¹⁴ This extension of the regulatory scope reflects the fundamental transformation of the television landscape and recognises the extension of broadcasters' (including public service broadcasters') and other providers' activities into new areas. In fact, recital 9 of the new Directive recognises that "the fulfilment of the mission of public service broadcasting requires that it continue to benefit from technological progress". However, there are a number of new media or online services the principal purpose of which is not provision of audiovisual media content and which therefore are not covered by the Directive, but which may well form part of public service remit, such as web-based text services.

In the light of the above, the Commission services consider at this stage that the Broadcasting Communication could include additional clarifications as regards the scope and definition of the public service remit in order to increase legal certainty. These clarifications could take into account the basic principles established by the Commission in its decision-making practice as well as changes in the legal framework conditions governing the audiovisual media sector. Based on the experience in individual cases, the Commission services think that an *ex ante* evaluation helps determining the public service character of new offers and avoiding disproportionate effects on competition. The Commission would like to engage in an exchange of views about the scope and general features of such an *ex ante* evaluation. Some Member States may already have provisions and mechanisms in place to determine the public service character of certain (or all) activities of public service broadcasters and which could be seen as examples of best practice.

¹³ Cf. State aid E 3/2005 – Germany.

¹⁴ Cf. Article 1 of Directive 2007/65/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directive 89/552/EEC on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities, Official Journal, 18 December 2007, N° L 332/27.

2.3. Entrustment and Supervision

According to the Broadcasting Communication, the public service remit shall be entrusted to one or more undertakings by means of an official act, but leaves the form of entrustment up to the Member State (cf. paragraph 40). Whenever the scope of the public service remit is extended to cover new services the entrustment act should be modified accordingly (cf. paragraph 35). The Broadcasting Communication also requires Member States to check that the public service mission is supplied as required, but leaves it to the Member State to choose the supervisory mechanisms. The Broadcasting Communication states in this respect that such a supervisory body would seem to be effective only if the authority is independent from the entrusted undertaking (cf. paragraphs 41 – 43).

Based on investigations in individual cases, the Commission services observe that some Member States have a differentiated system of public service definition and entrustment for certain activities. For instance, the general legal definitions and description of the public service mission and objectives are in some Member States further substantiated in additional legal documents such as performance contracts, agreements, "*cahiers de charge*", etc. In some cases the public service broadcasters were given the possibility to offer new media services, without the scope of the activities or the public service obligations being sufficiently clear. In such cases, the Commission expressed concerns about the public service broadcasters deciding on the scope of activities they considered as being covered by the relevant legal provision and required a further act of entrustment which contained a sufficiently detailed definition of the public service obligations.¹⁵

While requiring a precise definition as well as an amendment of the act of entrustment in order to add the new activities, the Broadcasting Communication does not contain further guidance in this respect. At this stage, the Commission services consider that further guidance could be given in a revised Broadcasting Communication in line with its decision-making practice and experience in Member States.

Member States have different ways of ensuring that the public service broadcaster fulfils its mission. The Commission services observe that only a few Member States have established an independent authority for supervising the fulfilment of the public service mission.

The Commission services recognise that it is up to the Member State to choose the mechanism to ensure effective supervision and has no general concern regarding the effectiveness of national supervisory mechanisms. However, the Commission services would like to discuss with stakeholders and Member States to what extent these mechanisms could be improved, so as to ensure that complaints concerning the fulfilment and scope of the public service broadcasters' activities could normally be dealt with primarily at national level. The Commission services would also like to discuss whether the involvement of third parties before the public service broadcasters are entrusted with new services could contribute to such an objective.

¹⁵ See for instance State aid C 85/2001 - *Ad-hoc payments RTP*, State aid NN 88/98, *BBC 24-hour news channel*, and more recently the decision concerning the financing of public service broadcasters in Germany, State aid E 3/2005.

2.4. Dual Funding of public service broadcasters

In paragraphs 44 - 48, the Broadcasting Communication recognises that the choice of funding falls within the Member States' competence and that Member States may opt for a system of dual funding (i.e. a combination of public funds with commercial revenues), provided that the relevant markets (e.g. advertising, acquisition and/or sale of programmes) are not affected to an extent contrary to the Community interest.

With the general acceptance of dual funding and based on information gathered in individual investigations, the Commission services see no apparent need to change the existing rules.

The Commission services observe that in some Member States public service broadcasters may be allowed to offer pay-services as part of their public service remit, thus partly benefiting from public funds. In this respect, the Commission services consider that there is a need for further clarification. First of all, there should be clarity as to the terminology: "pay-services" in this context would not normally be services for which the consumer pays access or transmission costs, but those services where the consumer makes content-related payments. While the inclusion into the public service remit of such services may not necessarily be a manifest error, the Commission services would like to have an exchange of views on the conditions under which the State funding of such services could be regarded as acceptable.

2.5. Transparency requirements

In paragraphs 49 - 56, the Broadcasting Communication sets out the requirements for a clear separation between public service and commercial activities, including rules for cost allocation in line with the requirements laid down in the Transparency Directive. As regards cost allocation, it is stated that not all costs (for instance those costs incurred by the production and distribution of programmes) need to be allocated to the commercial activities (e.g. advertising) since a *"full distribution of these costs between the two activities risks being arbitrary and not meaningful."* (cf. paragraph 56).

Member States have implemented the Transparency Directive¹⁶. Some have opted for a structural separation (i.e. setting up commercial subsidiaries) and have also obliged public service broadcasters to keep the financial relationships with their commercial subsidiaries at arm's length. To the extent that transfer prices can be established, it might also be possible to carry out a meaningful cost allocation in cases where the commercial activities are carried out within the public service broadcaster.

Where commercial activities are carried out within the public service broadcasters, it may not be excluded that such commercial activities benefit from other advantages, for instance resulting from a special legal status of the public service broadcasters with the consequence of enjoying an unlimited State guarantee or tax exemptions.

¹⁶ This applies to the Transparency Directive as amended in 2006 (Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, OJ L 318, 17.11.2006 , p. 17); the amendments of 2006 have not yet been implemented in all Member States.

At this stage, the Commission services consider that there may be scope for further clarification taking into account the experience at national level for instance with structural or functional separation between public service and other activities. Member States and stakeholders are invited to submit their views and possible examples of best practice.

2.6. Proportionality test – Exclusion of overcompensation

In paragraphs 57 – 62, the Broadcasting Communication states that State funding is normally necessary, in particular where quantitative and qualitative duties imposed on public service broadcasters entail supplementary costs that broadcasters would not normally have incurred. The compensation amount should be limited to the net public service costs, i.e. the costs incurred in providing the public service, after deducting the net revenues from its commercial exploitation.

When commercial activities are carried out through separate commercial subsidiaries which have an arm-length relationship with the public service broadcaster, the revenues to be taken into account to calculate the net public service costs are mainly those paid by the subsidiary for any input it receives from the public service broadcaster. However, if the commercial subsidiary is set up with public funds in accordance with the market economy investor principle, the dividends distributed by the subsidiary to the public service broadcaster also need to be taken into account when calculating the net public service costs. The requirement for commercial activities to be carried out under market conditions also requires that any transaction between the subsidiary and the public service broadcaster is carried out at market prices and that – in conditions referred to above – the public service broadcaster requires dividend payments as a normal market investor would do (see on this aspect also below, point 2.7).

In the context of individual investigations, the Commission asked Member States to introduce legal provisions limiting the entitlements for public service broadcasters to the net public service costs as defined in the Broadcasting Communication and to establish *ex post* control mechanisms avoiding overcompensation.

This means that public service broadcasters cannot in principle retain surpluses generated in fulfilling the public service remit and that they have to return them to the State at the end of the financial year.

There may however be valid justifications for public service broadcasters to keep a certain amount of surplus ("buffer") from one financial year to the other. For example, the need to react to fluctuations in costs and revenues¹⁷ or pluri-annual planning of investments. The Commission has accepted such a "buffer" under certain conditions.¹⁸ On the other hand, based on the circumstances of the cases under investigation, the Commission has so far not allowed public service broadcasters to keep a profit margin.¹⁹

¹⁷ For instance the possible need to cover lower than expected advertising revenues.

¹⁸ See for instance the decisions concerning the general funding regimes for public service broadcasters in Portugal (State aid E 14/2005) or Germany (State aid E 3/2005).

¹⁹ See for instance the Commission decision concerning the financing of TV2 (State aid C 2/2003); in that case, the Commission had *inter alia* pointed to the fact that the relationship between the State as owner of and provider

The difference between the buffer and the profit margin is that the former may only be used for public service purposes in the next financial period whereas a profit margin may be used also for other purposes, including commercial activities.

At this stage, the Commission services consider that there is a need for further clarification as regards the determination of the permissible public funds and the control of over-compensation in line with the Commission's decision-making practice in this respect. The Commission services consider that under certain conditions an annual surplus may remain at the public service broadcaster's disposal for fulfilling its public service tasks under conditions of financial stability. It therefore seems appropriate to incorporate the approach established in the Commission's decision-making practice into a revised Broadcasting Communication. There may however be scope for refining this approach in order to increase legal certainty further. In this respect, the Commission services also invite Member States and stakeholders to give their views on the effects of rules on overcompensation on e.g. the realisation by public service broadcasters of efficiency potentials.

The Commission services have at this stage doubts as to whether public service broadcasters should be allowed to keep a profit margin. There may however be circumstances in which this could be acceptable and the Commission services would therefore invite stakeholder and Member States to submit their views in this respect.

2.7. Proportionality test – exclusion of market distortions not necessary for the fulfilment of the public service mission

In paragraphs 58 - 61, the Broadcasting Communication refers to the Commission's task to check that there are no market distortions beyond those inherent in the justified funding of public service broadcasters. One example of anti-competitive behaviour explicitly mentioned in the Broadcasting Communication is the undercutting of prices on the advertising market. The Broadcasting Communication explains that where a public service broadcaster undercuts prices in non-public service activities below what is necessary to recover the stand-alone costs that an efficient commercial operator in a similar situation would normally have to recover, such behaviour – if demonstrated – could indicate the presence of overcompensation.

Given the risk inherent to the public funding, the Commission checked in individual investigations that public service broadcasters were subject to an explicit requirement to respect market conditions, including the prohibition to undercut prices. This included also the requirement for public service broadcasters to respect the arm's length principle for financial transactions with its commercial subsidiaries as well as the requirement for investments by public service broadcasters into commercial undertakings to respect the market economy investor principle.

At this stage and based on its experience in individual investigations, the Commission services consider that there is scope for increased transparency as regards the conditions under which public service broadcasters can carry out commercial activities. For instance, it appears useful to include in a revised Broadcasting Communication explicit

of public funds to the public service broadcaster was not one of a normal investor expecting a return on the capital invested.

requirements to respect market conditions (also outlining the specific obligations resulting there from) and effective control mechanisms which give other operators effective ways to pursue allegations of anti-competitive behaviour which may be the result of State funding and ensure that the State funding is not unduly increased through possibly anti-competitive behaviour. Existing mechanisms in Member States might provide examples of best practice. As regards the specific obligations for public service broadcasters, the Commission services would invite stakeholders and Member States in particular to submit their views on possible further clarifications of the test used to avoid and control undercutting of prices in the advertising market.

Some private operators allege that public funding of excessive exclusive premium sports rights have disproportionate effects on competition by unduly limiting their possibilities to acquire such rights.

While the Commission services consider that the public funding of premium sports rights does not *per se* unduly affect competition and trade within the meaning of Article 86 (2) EC Treaty, there may indeed be circumstances where additional safeguards might be necessary. This questionnaire therefore gives stakeholders and Member States the possibility to express their views in this respect.

2.8. Other issues

In paragraph 62, the Broadcasting Communication states that the specific difficulties of some smaller Member States would be taken into account (reference is made to difficulties to collect the necessary funds, difficulties with regard to broadcasting being addressed to linguistic minorities or to local needs). This provision has, however, never been invoked by Member States.

While, based on past experience, there would therefore not seem to be a specific need for such a provision in the Broadcasting Communication, the Commission services invite Member States and stakeholders to express their views on the potential scope of this provision.

3. FINAL REMARKS

Before deciding on whether any changes should be brought to the current Broadcasting Communication, the Commission will carefully evaluate the potential impact of such changes. Member States and stakeholders are therefore invited to give their views in this respect.