



EUROPEAN COMMISSION

Brussels, 13.09.2006

PUBLIC VERSION
WORKING LANGUAGE
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Subject: **N 264/2006 - Italy**
 Broadband for rural Tuscany

I. PROCEDURE

- (1) By letter registered on 25 April 2006, pursuant to Article 88 (3) of the EC Treaty, the Italian authorities notified the planned “Broadband for rural Tuscany” project to the Commission. By letter of 17 April 2005, the Commission requested additional information on the proposed measure, which the Italian authorities provided by letter dated 23 June 2006, registered on 26 June 2006. They provided further information by letter dated 27 July 2006.

II. CONTEXT

- (2) Broadband connectivity¹ is a key component for the development of knowledge-based global, national, regional and local economies and the development, adoption and use of information and communication technologies. Broadband is of strategic importance because of its ability to accelerate the contribution of these technologies to economic growth in all sectors, to enhance social development and to facilitate innovation.
- (3) However, with regard to Italy, despite the fact that the digital communication market is rapidly growing, some regions are characterised by a concrete risk of

¹ Broadband services can be delivered using various combinations of communications network technologies (“platforms”). Technologies can feature either fixed or radio based transmission infrastructure, and they can substitute or complement each other according to the individual situation. Current mass-market broadband services have generally download speeds starting from 512Kbit/s/ - 1Mbit/s. For business users, much higher speeds are needed.

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“digital divide”, mainly due to lack of interest of operators in bringing broadband connectivity in those areas where the density of population and industrial concentration does not allow to exceed the profit threshold.

- (4) According to the Italian authorities, parts of Tuscany fulfil this definition. While approximately 82.1% of the Tuscan population has access to a mass-market “non-shared”² broadband solution, broadband availability falls in mountain/hill towns, rural villages and remote areas. The Italian authorities consider that 110 municipalities do not have access to broadband. Furthermore, even in municipalities that have access to broadband, some marginal areas are not covered by ADSL, because they are too distant from the local exchanges.
- (5) Studies that are carried out at the national level, in particular by the Osservatorio Banda Larga indicate that in Tuscany, about 400,000 inhabitants and 30,000 firms are confronted with the digital divide.

III. DESCRIPTION OF THE MEASURE

- (6) *Objective:* In its first phase, the objective of this measure is to support investments necessary to ensure access to broadband connection to half of the population of Tuscany that does not have access to it now by 2007. Depending on the resources available, the second objective will be to provide such access to the rest of the population by 2010.
- (7) *Legal basis:* The measure is based on the Legislative Decree of 1 August 2003 n° 259 “Codice delle comunicazioni elettroniche”, the Legislative Decree of 7 March 2005 n°82 “Codice della pubblica amministrazione digitale”, the Regional Law 1/2004 “Promozione dell’amministrazione elettronica e della società dell’informazione e della conoscenza nel sistema regionale. Disciplina della Rete Telematica Regionale Toscana” and the decision of the Regionale of 9 January 2006 n° 4 “Linee di indirizzo per un progetto Integrato Regionale: infrastrutture ICT per la Società dell’informazione e della conoscenza con particolare riferimento al coordinamento degli interventi relativi a infrastrutture a servizi in banda larga”.
- (8) *Target areas:* The project is aimed at Tuscany, and more specifically at areas where the market would not provide broadband infrastructure without State support. These areas have been identified by the Italian authorities following an investigation in the course of which several telecommunication operators (Telecom Italia, Fatsweb, Eutelia, Infracom, Multilink, Consiagnet, ePlanet and Momax) were contacted and provided information on technologies that could be deployed to cover the marginal areas, business plans and expectations about return on investments along a time span of three to five years. This study provided a clear map of the areas where market forces will not provide broadband infrastructure because of a lack of profitability. In the context of the identification of these areas, the Italian authorities took into account the

² I.e. broadband solution where the access segment is reserved (e.g. ADSL), unlike what happens for satellite access and wireless terrestrial last mile.

investment plans of these firms and only included in the areas concerned by this intervention those that will not be covered in the short or medium term. The Italian authorities identified three types of areas:

- (a) Areas where a balance between costs and revenues is possible but over a time-span that is deemed too long by the operator;
 - (b) Areas for which the expectation about the revenues are not able to cover the maintenance of the infrastructure and the annual mortgage related to the cost of the infrastructure;
 - (c) Areas where the expectation about the revenues are not able to cover the maintenance of the infrastructure itself.
- (9) *Infrastructure:* in order to provide broadband access to the targeted areas, the beneficiary will be able to use its own broadband infrastructure, build new one, or acquire or rent infrastructure from another operator.
- (10) *Service definition:* The scheme promotes investment in broadband infrastructure capable of providing broadband services with a minimum connection speed of 640 kbit/s in download and 128 kbit/s in upload, with a maximum content ratio of 50:1.
- (11) *Wholesale and retail offer:* All telecommunication operators will have wholesale access to the subsidised infrastructure, on non-discriminatory conditions, and the tender will oblige the selected operators to provide whole sale services to other operators on equal and non-discriminatory conditions that enable them to replicate their own retail offers. With respect to retail services, the Italian authorities indicated that the successful tenderer will have to offer retail services to the end users at prices that are comparable to the average price applicable in areas where such service already exists.
- (12) *Procurement:* The scheme will give rise to one or several tenders (depending on the available resources). Each tender will be subdivided in lots corresponding to a province of Tuscany. The tender will have to respect Community rules concerning tenders. For each province, a list of cities interested by the support action will be indicated. The contenders will be invited to provide their best service coverage along with a suitable business plan for the development of broadband market in the province area. These plans will have to indicate the amount necessary to balance the anticipated costs of the project (investment costs, operating costs) and the anticipated revenues (from residential users, business users and wholesale users). At the end of the bid process, a single operator will be chosen for each lot. The criteria that will be used in the selection process are the following:
- (a) Maximize the number of potential residential and business users interested by the action;
 - (b) Maximize the number of low-population density cities interested by the action;
 - (c) Prefer long-term scalable technologies;

- (d) Allow wholesale redistribution of services;
- (e) Minimize the number of digitally divided industrial districts.

The criteria will be implemented through scoring and the operator with the highest score will be chosen.

- (13) *Technology*: The Italian authorities will not specify the technology in the invitation to tender.
- (14) *Beneficiaries*: The direct beneficiaries of the measure will be the selected operators. Indirect beneficiaries will be third party providers of telecommunication services and business end users in the targeted areas.
- (15) *Budget and funding instrument*: Public funds will be paid to the selected operators in the form of a grant. The annual amount will be 6 million €. The total amount for all the lots and for the whole duration of the scheme will be 20 million €. 6 million € will be provided by the Region of Tuscany, another 6 million € by the provinces of Tuscany, and the remaining 8 million € by the European Regional Development Fund.
- (16) *Aid intensity*: The maximum aid intensity will be up to 80% of the total costs of the project.
- (17) *Duration of the measure*: This intervention will be carried out over the 2006-2010 period.
- (18) *Monitoring and clawback mechanism*: The Italian authorities will conduct a monitoring of the level of services provided by the beneficiaries. Every six months, they will have to provide information on the level of activation of the infrastructure. Every three months, they will have to provide the number of requests of access to the network received from individuals and undertakings as well as from other telecommunication operators. Furthermore, a clawback mechanism is foreseen. As indicated above, each contender must provide a business plan, with an estimate of the investment and operating costs, and anticipated revenues. The tenderers selected will have to keep transparent accounts on the investment. In case receipts are higher or the costs lower than initially anticipated in the tenderers' business plan, it is foreseen that the amount of the aid will be reduced in proportion of the receipts that exceed the amounts anticipated.
- (19) *Non recovered unlawful aid*: The Italian authorities provided a commitment to suspend the payment of the aid to companies that have not reimbursed or put on a blocked bank account any unlawful or incompatible aid (including interests) received in application of the following aid measures or any other decision:
 - (a) CR 49/98 – Aiuti concessi dall'Italia a favour dell'occupazione;
 - (b) CR 27/99 – Esenzione sulle imposte sul reddito e prestiti ad interesse agevolato in favore di aziende municipalizzate a maggioranza pubblica
 - (c) CR 62/2003 – Disposizioni urgenti in materia di occupazione;

- (d) CR 57/2003 – Proroga della legge “Tremonti bis” . Legge n.27/2003 art.5 sexies.

IV. ASSESSMENT OF THE MEASURE: PRESENCE OF AID

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

State resources

- (21) A significant part of the aid will be provided by the Region and provinces of Tuscany. Furthermore, structural funds are deemed to be state resources once they have been passed on to the Member State for use. Hence, state resources are involved.

Economic advantage

- (22) *Selected telecommunication operators:* Even if a telecommunication operator selected by open tender would not receive an excessive return on its overall investment, it receives financial support which provides the possibility of establishing its business in certain areas on conditions not otherwise available on the market. It is likely that the State intervention will allow the service provider to offer the services at lower prices than it would have been able to offer had it had to bear all the costs itself and, as a consequence, such a service provider will be able to attract more customers than under normal conditions.
- (23) *Third party providers:* In the areas covered by the project, there is no broadband connection and therefore no broadband wholesale offer at all, preventing market entry of third parties such as service providers which do not have their own infrastructure. Therefore, third party providers of broadband services using wholesale access provided under the measure might also benefit from the State resources, as they will be customers of the selected telecommunication operators.
- (24) *End users:* The objective of the measure is to provide broadband services to residential users and businesses at conditions which are currently not available in the target areas. Whereas residential users are not subject to State aid rules, businesses in the targeted geography will benefit from service coverage beyond and prices below what would be provided purely on a commercial basis like, in some areas, satellite connections.

Distortion of competition

- (25) The intervention of the State alters the existing market conditions by allowing the provision of broadband services by the selected telecommunication operators and, potentially, third party providers. A number of firms are likely to subscribe to the services provided by the selected suppliers instead of more expensive market-based solutions (for instance satellite). Therefore, the fact that a new broadband service becomes available at a lower price than existing has the effect of distorting competition.
- (26) In addition, while the Italian authorities decided to intervene precisely in view of the lack of private initiatives in at least some of the concerned areas, it cannot be excluded that market initiatives could become viable in some areas in the longer term. By securing this project, the chosen operators will be capable of establishing their business and developing their customer base, enjoying a first mover advantage over prospective competitors.
- (27) The scheme is also selective in that it is addressed to undertakings active only in certain regions or in certain markets for electronic communications services. These selectivity elements also induce a potential distortion of competition.

Effect on trade

- (28) 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. There may also be an effect on trade between the businesses using the broadband services enabled by the measure and their competitors in other Member States.

Conclusion

- (29) In view of the above, the Commission considers that the notified measure grants an economic advantage to the selected operators, third party operators and final users that exercise an economic activity. The project is publicly funded, distorts competition and has an effect on trade between Member States. Therefore the Commission regards the notified measure as constituting State aid within the meaning of Article 87 (1) of the EC Treaty.
- (30) Having established that the project involves aid within the meaning of Article 87(1) of the EC Treaty to the selected service providers, third party providers using the open access provision and to businesses, it is necessary to consider whether the measure can be found to be compatible with the common market.

V. ASSESSMENT OF THE MEASURE: COMPATIBILITY

- (31) The Commission notes that the project aims to ensure the widespread availability and use of high-speed broadband services in currently unconnected areas with no prospect for coverage on commercial terms in the near and medium term and, as such, does not fall under one of the existing frameworks and guidelines. In particular, this aid cannot be analysed on the basis of the Regional aid guidelines. Some of but not all the areas covered by the project are located within areas eligible under Art. 87 (3) (c) within the

meaning of the Regional Aid Guidelines. In any case, while the aid to be granted under the scheme may in some cases qualify as aid for initial investment within the meaning of those guidelines in so far as it benefits the broadband providers, the same cannot be said in respect of its impact on the third party operators and end users, for whom the benefit is not linked to any initial investment.

- (32) The Commission therefore considers that the assessment of the compatibility of the measure with the common market needs to be based directly on Article 87(3)(c) of the EC Treaty³ which states that:

“aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest”

may be considered to be compatible with the common market.

- (33) In order to be compatible under article 87(3)(c), an aid must pursue an objective of common interest in a necessary and proportionate way. In this context, it is appropriate to 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, i.e. are there other, better-placed instruments?
 - (b) Is there an incentive effect, i.e. does the aid change the behaviour of firms?
 - (c) Is the aid measure proportional, i.e. could the same change in behaviour be obtained with less aid?
- (3) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

5.1. The support of broadband rollout is in line with the common interest

Community policy

- (34) As outlined in its Communication “i2010 – A European Information Society for growth and employment”⁴ and the eEurope Action Plan 2005⁵, the Commission actively supports the widespread availability of broadband

³ This approach was also followed by the Commission in other cases, see for instance: State aid decisions for the UK: N126/04 “Broadband for SMEs in Lincolnshire” of 14.12.2004, N199/04 “Broadband business fund” of 16.11.2004, N307/04 “Broadband in Scotland – remote and rural areas” of 16.11.2004 (See: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/).

⁴ COM(2005)229 final, 1 June 2005.

⁵ COM(2002)263 final, “eEurope 2005: An information society for all”.

services. There is clear evidence of regional economic development benefits resulting from greater broadband deployment, including job creation and retention as well as improved health and education services⁶. In order to achieve better broadband coverage, the Commission encourages Member States to put comprehensive national broadband strategies in place.⁷ The measure at hand forms an important part of the broadband strategy in Tuscany. By improving broadband access for citizens and businesses in areas of Tuscany where these services are not yet available, the measure helps achieving greater cohesion and is therefore in line with the common interest.

Cohesion objective and market failure considerations

- (35) Lack of broadband coverage is due, among others, to some of the typical economic problems associated with networks industries. Due to economics of density, broadband networks are generally more profitable to roll-out where potential demand is higher and concentrated, i.e. in densely populated areas. Because of high fixed costs, unit costs escalate dramatically as population densities drop. Remoteness also plays a role, requiring bridging longer distances in the backhaul and in the last mile. In other cases it has been estimated that approximately 65-70% of the costs associated with the deployment of broadband in the access network is related to civil infrastructure⁸. In addition, although equipment costs have fallen as volumes increase, they remain a significant cost and major barrier to roll-out. In areas where demand is not very developed and coverage of cost is uncertain, private operators might find it difficult to find a source of funding for broadband infrastructure, which has a long life and amortisation period.
- (36) Hence, by providing financial support for the establishment of infrastructure to provide basic wholesale and retail broadband services in such areas of Tuscany, the authorities pursue genuine cohesion and economic development objectives.

5.2. Well-designed aid

(a) Aid is the appropriate instrument

- (37) This State intervention is part of several instruments that support the development of broadband connection in Italy, and more specifically in Tuscany.
- (38) On the supply side, tariff and access regulation imposed by the Italian regulator is one of those instruments. Indeed, regulation has led to the availability of a number of broadband wholesale products and prices have been decreasing over the past years. However, regulation was a necessary but

⁶ For an overview, see: Lehr, Osorio, Gillet and Sirbu (2005): "Measuring Broadband's Economic Impact", and Orazem, Peter, University of Kansas Business School (2005), "The Impact of High-Speed Internet Access on Local Economic Growth".

⁷ Commission Communication COM(2004) 369 of 12.05.2004, "Connecting Europe at High Speed – National Broadband Strategies".

⁸ Broadband Stakeholders Group "Broadband in Rural Areas", 2003.

not sufficient instrument to enable the supply of broadband in rural and remote regions as alternative providers need to combine the use of wholesale products from the incumbent with their own network investments which may not be profitable in areas where demand is low.

- (39) On the demand side, measures are also possible. For instance, the regional authorities of Tuscany have tried to stimulate demand in the area of services for public administration, by creating and promoting the “Rete Telematica Regionale Toscana” (regional telematic network of Tuscany), which is meant to provide services to all public bodies in Tuscany. It has also supported initiatives in favour of the aggregation of demand of connection by citizens and firms in marginal areas so that it becomes more profitable and stimulates supply by operators. It has also promoted the development of e-government and on-line and content services in order to increase the number of potential users.
- (40) Despite these initiatives, there are still many areas where the provision of broadband connection remains unprofitable in the short and middle term and for which the present notified intervention is considered to be necessary by the Italian authorities.
- (41) On balance, in view of the limited availability of broadband in rural and remote areas of Tuscany, the Commission concludes that the support provided by the notified measure is an appropriate instrument to achieve the set objectives.

(b) The aid provides the right incentives to operators

- (42) As explained above, the recipients of the aid will be selected by public tenders in which they will submit investment plans indicating the amount of aid that they consider to be necessary to carry out the investment given the anticipated investment and operating costs and anticipated revenues. Therefore, this State aid should provide a direct and appropriate investment incentive for the selected operators.

(c) Proportionality

- (43) The Italian authorities have designed the measure in such a way as to minimise the State aid involved and potential distortions of competition arising from the measure. In this respect, the Commission notes, inter alia, the following positive elements in the design of the measure:

- (a) *Open tender*: the recipients of the aid will be selected by one or several open tender(s). These open tenders will have the effect of maximising the effect of the aid provided. Furthermore, they will be divided in smaller lots corresponding to the different provinces of Tuscany, which will have the effect of increasing the number of potential (and in particular smaller) participants, and will therefore stimulate competition.

- (b) *Wholesale access*: The Italian authorities have confirmed that the selected operators will have to provide access to the subsidised networks to other operators on equal and non-discriminatory terms that will enable the latter to replicate their formers' offers.
- (c) *Minimising effects on existing infrastructure providers and operators*: The freedom for the service providers to choose the most efficient way of procuring the necessary infrastructure, either by building, buying or leasing it from third parties minimises duplication and enhances economic efficiency. Existing operators have the possibility to contribute their infrastructure to the project, which limits the economic impact of the project for operators that may already have basic electronic communications infrastructure in place.
- (d) *Minimisation of price distortion*: The Italian authorities confirmed that the selected operators will have to offer retail services at prices that are comparable to the average prices in areas where the service already exists.
- (e) *Technological neutrality*: The project is technologically neutral, i.e. it does not favour a priori any given technology.
- (f) *Clawback provision*: The monitoring and clawback provision will ensure that if the beneficiaries make profits that are higher than initially foreseen in its investment plan, a proportional amount of the aid will be repaid.

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

- (44) 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 broadband services due to the insufficient density of potential and actual subscribers to make delivering broadband services economically viable on a purely market-driven basis. The target group of the scheme includes both local businesses and citizens who will benefit from the availability of broadband services in both their day-to-day business activity and in the quality of life benefits that access affords to citizens.
- (45) In view of the characteristics of the project and of the safeguards applied by the Italian authorities, the overall impact on competition is deemed to be positive. On the effect on trade, the Commission does not identify negative spill-over for other Member States.
- (46) On balance, the Commission concludes that the overall effect of the measure is deemed to be positive. The measure is clearly in line with the objectives of Article 87 (3) (c) EC Treaty as it facilitates the development of certain economic activities (retail and, indirectly, wholesale broadband services) in certain remote and rural areas. The intervention is designed in a way that does not distort competition or affect trading conditions to an extent contrary to the common interest.

5.4 Conclusion

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

VI. DECISION

On the basis of the foregoing assessment, the Commission has accordingly decided that the aid measure “Broadband for Rural Tuscany” is compatible with Article 87(3)(c) of the EC Treaty.

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Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission