



EUROPEAN COMMISSION

Brussels, 10.I.2008
C(2008)42

**Subject: State aid N 692/2007 – United Kingdom
Amendment of N 131/2005 Fibrespeed broadband project Wales**

Sir,

I. SUMMARY

- (1) I am pleased to be able to inform you that the European Commission has assessed the measure "Amendment of N 131 / 2005 Fibrespeed broadband project Wales" (hereafter "the measure") and decided not to raise objections as the State aid contained therein is compatible with Article 87 (3) (c) of the EC Treaty.

II. PROCEDURE

- (2) Following informal pre-notification contacts between the Commission and the United Kingdom authorities ("UK authorities"), by letter dated 23 November 2007, registered on the same day, the UK authorities notified the above mentioned measure to the Commission. On request of the Commission, the UK authorities provided further information on the measure on 12 December 2007.
- (3) The notified measure is the amendment of a previously authorised State aid measure, which was endorsed by the Commission decision in case N 131 / 2005 - Fibre Speed Broadband Project Wales¹ ("the original measure").

¹ N 131 / 2005 "Fibre Speed Broadband Project Wales" of 22 February 2006, OJ C 207 30 August 2006.

The Rt Hon David MILIBAND
Secretary of State for Foreign Affairs
Foreign and Commonwealth Office
King Charles Street
London SW1A 2AH
United Kingdom

III. DESCRIPTION OF THE MEASURE

- (4) ***The original measure.*** The primary objective of the original aid measure was to ensure the availability of affordable advanced broadband services² primarily for small and medium sized enterprises located in 14 business parks in rural areas of North Wales. This was envisaged to be achieved by the construction of an open, carrier-neutral, regional fibre-optic network linking these business parks over which wholesale services will be offered to retail operators who will serve business end users. The infrastructure would remain in public ownership but would be managed by a wholesale operator.
- (5) By providing access to an open regional wholesale broadband network in North Wales, the original measure also aimed to generate spill-over effects on the broadband accessibility in the concerned areas in general³, thereby contributing to a range of policy and strategic objectives for Wales, supporting the economic, social and rural development of Wales⁴.
- (6) In its assessment of the original measure, the Commission found that the measure constitutes State aid within the meaning of Article 87 (1) of the EC Treaty. The aid involved was found to be compatible with Article 87 (3) (c) of the EC Treaty.
- (7) The original measure foresaw that the UK authorities would conduct an open tender for the construction and management of the network in accordance with EC rules and principles on public procurement. As a result of the tender procedure, certain elements of the notified measure have changed. Therefore the UK authorities decided to notify the amended version of the original measure in compliance with Article 88(3) of the EC Treaty.
- (8) ***The amended measure.*** The UK authorities followed the competitive dialogue procedure in compliance with Directive 2004/18/EC⁵. Article 29 (1) of the referred Directive, provides that when this award procedure is employed for the purpose of awarding a public contract, the sole basis on which the contract shall be awarded is the award criterion for the most economically advantageous tender. The UK authorities have therefore proceeded on this basis⁶.
- (9) Following the tender procedure, the UK authorities envisage that the aid intensity of the measure might temporarily exceed the maximum aid intensity of 67% approved for the original measure.

² Defined as broadband services with a minimum bandwidth of 10 Mbps symmetrical (upstream/downstream).

³ For instance by providing backhaul for local loop unbundling or wireless operators.

⁴ For the description of the underlying project in case N 131 / 2005 "Fibre Speed Broadband Project Wales", see paragraphs 14 to 27 ff. of that decision.

⁵ Recital 31 of Directive 2004/18/EC refers to large computer networks as a typical example for the use of this procedure.

⁶ The tender procedure was published in the OJEU with reference to 2006 / S 151-163480 on 10 June 2006. The procurement exercise was concluded in the summer of 2007.

- (10) In particular, the UK authorities envisage three business scenarios and three different levels of aid intensities required for the measure at hand⁷.
- Scenario 1, "base case scenario": The business plan for the project is successful and the objectives of the project are achievable. In this case the anticipated maximum public funding is GBP 19.19 million, and the total budget of the project GBP 42.26 million. This scenario would therefore result in an aid intensity of 45%. Based on extensive market analysis and the enquiries by the selected operator with potential customers, the UK authorities consider that this scenario is the most realistic one.
 - Scenario 2, "worst case scenario with termination of the project": If the business plan of the project would immediately prove to be unviable, and also the objectives of the measure are considered not achievable, the UK authorities terminate the project after 4 years. This scenario would require a maximum aid amount of GBP 20.82 million, a total project budget of 27.43 million, resulting in a temporary aid intensity of 76%.
 - Scenario 3, "worst case scenario without termination of the project": If the business plan of the project would prove to be unviable due to significantly lower revenues than in the base case, but the objectives of the measure are considered to be achieved, the project is not terminated after four years, but the scope would be reduced⁸. Based on this scenario the maximum public funds that can be committed would be GBP 22.5 million, the total project budget GBP 29.84 million, hence this scenario would result in a temporary maximum aid intensity of 75%.
- (11) In the view of the UK authorities, it is unlikely that the referred aid intensities of Scenario 2 or 3 would materialise, as this would assume that there is no single customer for the service provider. In such case, it is assumed that there would be no revenues for the new broadband network during the complete contract period (for 4 years in case of termination, or for 15 years in case of a normal operation of the contract)⁹.
- (12) In any event, the UK authorities have inserted a contractual obligation requiring the beneficiary of the aid to pay back any aid exceeding the maximum aid intensity of 67% originally approved by the Commission. Therefore, the contractual obligation with the selected operator ensures that the overall aid intensity will not be higher than approved in the original measure. It follows that any increase in the aid intensity will necessarily be only temporary.
- (13) The UK authorities notified the amendment of the approved State aid measure N 131 / 2005 with the foreseen maximum temporary aid intensities for reasons of legal certainty.

⁷ All figures were calculated on a comparable basis based on net present value calculations.

⁸ The contract provides the option for the UK authorities to reduce the scope of the project in case the financial outcome of the measure is not attractive. The reduced scope would provide only a basic set of services on the fibre network, thereby significantly reducing the operating costs of the fibre network. Therefore, this option would enable the UK authorities to manage their risk exposure.

⁹ Although in scenario 3, the decision to reduce the scope of the services provided would imply revenues greater than zero (otherwise scenario 2 would apply), these revenues would be significantly lower than in the base case scenario (scenario 1). Therefore the foreseen aid amount and aid intensity in this scenario can be considered as a theoretical maximum.

IV. ASSESSMENT OF THE MEASURE

- (14) The UK authorities have complied with the procedural requirements of Article 88(3) of the EC Treaty by notifying the changes to the original, approved measure.
- (15) The notified measure is an amendment to the measure N 131 / 2005 "Fibre Speed Broadband Project Wales", which was approved by the Commission on 22 February 2006. Although the Commission found that the measure constitutes State aid within the meaning of Article 87 (1) of the EC Treaty, the aid involved was found to be compatible with Article 87 (3) (c) of the EC Treaty.
- (16) As regards the change of the envisaged aid intensity of the measure at hand, the Commission has to assess the compatibility of the aid measure in light of the notified changes.
- (17) The Commission considers that its findings about the necessity of the project did not alter compared to the approved aid measure. The project targets economic cohesion objectives and boosts economic development and competition by providing necessary infrastructure and wholesale services at conditions not offered by market players¹⁰.
- (18) The notified change of the aid measure (higher aid intensity) could, in theory, have an effect on the proportionality assessment of the measure and therefore affect the overall balance of the amended measure. This possibility is assessed in the following.
- (19) As regards the proportionality assessment of the measure, first, the Commission finds that the UK authorities awarded a public service contract to the service provider selected on the basis of an open, transparent and non-discriminatory tender procedure, following publication of a contract notice in the Official Journal of the European Union, which appears to have been conducted in a manner compatible with the EC public procurement rules and principles. As a result, the Commission considers that the level of aid is the minimum necessary for the project to proceed.
- (20) Second, when the Commission approved the original measure, the Commission not only assessed the overall aid amount and intensity involved in the measure, but also considered that several appropriate mechanisms were implemented by the UK authorities which would ensure the proportionality of the measure. In this respect, the Commission notes that the positive elements of the notified measure (such as, *inter alia*, the open tender, wholesale character of the project, the clawback mechanism and minimisation of price distortion)¹¹ remained unchanged.

¹⁰ See decision in case N 131 / 2005, paragraphs (28) and ff.

¹¹ See paragraph (52) of the decision in case N 131 / 2005.

- (21) In particular, the clawback mechanism will ensure that the wholesale operator is not making excessive returns. Based on the information provided by the UK authorities, there is a contractual obligation between the authorities and the selected operator, supported by recovery provisions, that the overall State aid intensity will not exceed the approved level in the original measure. Therefore any State aid intensity exceeding the approved 67 % of the original measure will necessarily be temporary¹².
- (22) The Commission also notes that based on the information provided by the UK authorities, it is most likely that the necessary aid intensity will not exceed 45 % (scenario 1) supported also by a thorough market analysis of the areas concerned. The UK authorities consider that the probability that temporarily higher aid intensities of scenario 2 and 3 proved to be necessary is marginal, as these scenarios imply with zero revenues during the whole lifetime of the measure¹³. In addition, the foreseen higher aid intensities, if they materialized, would mainly be resulting from the downsizing of the project, hence the reduced total costs of the measure (and not from higher aid amounts).
- (23) As regards the overall balance of the amended measure, all the conditions foreseen under the previously authorised measure remain unaltered. As highlighted in the Commission's approval of the original project, the UK authorities have designed the measure in such a way as to minimise the State aid involved and the potential distortions of competition arising. Any possible higher aid intensities of the amended measure have resulted from the complex nature of the project and the uncertainty of predicting the necessary aid amounts before conducting the public procurement and would only temporarily materialize under specific worst-case scenarios.
- (24) Based on these considerations, the Commission concludes that the theoretical higher aid intensities as notified by the UK authorities are only temporary in nature, and therefore to not change the assessment of the measure. As all other elements of the measure remain unchanged, the Commission's assessment as regards the overall compatibility of the measure is not altered: the measure is both necessary and proportionate to the objective it pursues and it is designed in a way that does not affect trading conditions to an extent contrary to the common interest.

V. DECISION

- (25) On the basis of the foregoing assessment, the Commission considers that the Amendment of N 131 / 2005 Fibrespeed broadband project Wales, which is an aid measure within the meaning of Article 87(1) of the EC Treaty, is compatible with the common market pursuant to Article 87(3) (c) of the EC Treaty.
- (26) The UK authorities are reminded that, pursuant to Article 88(3) of the EC Treaty, they are obliged to inform the Commission of any plan to extend or amend the measure.

¹² The possible temporary higher aid intensities under the worst case scenarios are the result of the prudent approach of the UK authorities to take into account all risks and opportunities related to the project.

¹³ Cf. paragraph (11) of this letter.

- (27) If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the internet site:

http://ec.europa.eu/community_law/state_aids/index.htm.

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

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

Yours faithfully,
For the Commission

Neelie KROES
Member of the Commission