



EUROPEAN COMMISSION

Brussels, 07.06.2006

C (2006) 2085

**PUBLIC VERSION**

**WORKING LANGUAGE**

**This document is made available for  
information purposes only.**

**Subject:**        **State aid n° N 118/2006 – Latvia**  
                         **Development of broadband communication networks in rural**  
                         **areas**

Sir,

## **I. PROCEDURE**

- (1) By letter dated 17 February 2006, and registered on the same day, the Latvian authorities notified to the Commission, pursuant to Article 88(3) of the EC Treaty, a measure for the development of broadband communications networks in the rural areas of Latvia (“the notified measure”). By letter of 15 March 2006, the Commission asked for complementary information concerning the notified measure.
- (2) The Latvian authorities replied to the Commission’s request for further information by letter registered on 12 April 2005.

## **II. CONTEXT**

- (3) Broadband connectivity<sup>1</sup> is a key driver for the development of knowledge-based global, national, regional and local economies and the development, adoption and usage of information and communication technologies. Broadband is of strategic importance because of its ability to accelerate the contribution of these

---

<sup>1</sup> 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 in the EU-15 have generally download speeds starting from 512Kbit/s/ - 1Mbit/s. For business users, much higher speeds are generally needed.

Viņa ekselence Artis PABRIKA KUNGS  
Ārlietu Ministrs  
Brīvības bulvāris 36  
LV-1395 Rīga

Commission européenne, B-1049 Bruxelles / Europese Commissie, B-1049 Brussel - Belgium.  
Telephone: (32-2) 299 11 11.

technologies to economic growth in all sectors, to enhance social development and to facilitate innovation.

- (4) Implementing the eEurope Action Plan 2005 and the i2010 initiative<sup>2</sup>, most Member States have put comprehensive national broadband strategies in place<sup>3</sup>. The notified measure aims at boosting investments in broadband infrastructure (backhaul) to improve connectivity for providers of broadband local access in order to offer end-users broadband services at affordable prices and to bridge the digital divide between those that can get broadband access (mainly in urban areas) and those that cannot (rural areas).
- (5) More particularly, the implementation of broadband technologies in the rural areas in Latvia is facing two principal problems, namely the fact that (i) the connection points (households) are geographically scattered rendering the necessary initial investments in rural areas much higher than in the territories with dense population (cities), and (ii) the inhabitants of rural areas have generally a lower income and thus are unable to pay for the actual costs of the service. As a result, broadband access operators are not interested in investing and providing broadband services in such areas<sup>4</sup>.
- (6) In the light of the very low digitalisation of fixed networks, broadband networks only cover at present 15% of the territory of Latvia. This low penetration is detrimental to the deployment and widespread availability for all citizens of important information society services provided not only by private operators but also by the State (i.e. e-Government; e-Health; e-Work; e-Education, etc.).
- (7) In order to bridge the gap between rural and urban areas, on the one hand, and between Latvia and other EU countries, on the other hand, the Latvian government approved on 9 March 2004 an "Order" setting out the "*Policy Position of the Republic of Latvia on electronic communications for the years 2004-2008*"<sup>5</sup>. The establishment of a nation-wide broadband communications infrastructure, including the provision of broadband services in rural and peripheral areas, is one of the strategic tasks of that policy. As part of a series of legislative measures aimed at improving the situation of the IT/electronic communications sector in Latvia, on 13 December 2005, the Latvian government approved a '*Strategy for the Development of the Broadband Networks for the years 2006-2012*'. The stated aim is to ensure, by 2012, the availability of broadband access in 85% - 95% of the State territory.
- (8) To this end, the Latvian authorities have decided to provide State funding, including funds allocated from the European Regional Development Fund, to undertakings (network operators) willing to invest in building broadband infrastructure (backhaul) in rural and peripheral areas of the country.

### III. DESCRIPTION OF THE MEASURE

---

<sup>2</sup> <http://europa.eu.int/i2010>

<sup>3</sup> Commission Communication COM(2004) 369 of 12.05.2004, "Connecting Europe at High Speed – National Broadband Strategies"

<sup>4</sup> According to the Latvian authorities, the ratio of broadband network lines in Latvia in 2004 was 1.5 lines to 100 inhabitants, that is 5 indicative points less than EU average.

<sup>5</sup> Order of the Cabinet of Ministers No.154.

- (9) *General objective:* The notified measure aims at promoting investments in broadband infrastructure capable of providing broadband services in geographic areas of Latvia which are currently not served and where there are no plans for coverage in the near future. The measure thereby aims at strengthening the territorial cohesion by preventing the creation of a broadband digital divide between communities and businesses that can get access to broadband services at a competitive market price and those that cannot. The Latvian authorities expect that the development of broadband in rural and remote areas characterised by low levels of economic activity, below-average per capita income and high unemployment will significantly improve the living conditions and contribute to the economic development of these disadvantaged areas.
- (10) *Legal basis:* The measure is based on a series of interrelated government initiatives for a comprehensive national broadband policy, including in particular the “*Policy Position of the Republic of Latvia on electronic communications for the years 2004-2008*” and the ‘*Strategy for the Development of the Broadband Networks for the years 2006-2012*’ adopted on 13 December 2005 (see above, point 7) in accordance with the “*Implementation Programme for the Basic Policies for the Electronic Communications Sector for the years 2004-2008*”, adopted on 21 April 2005.
- (11) *Main features of the measure:* The notified measure is implemented by means of a tender procedure. It will provide funding to successful bidders for the establishment of high-quality broadband network infrastructure (backhaul) necessary for the provision of broadband access services to end-users at a short notice in any geographical area of a particular administrative territorial region of Latvia, at an affordable price<sup>6</sup>.
- (12) *Service definition:* The measure aims at the deployment of backhaul broadband infrastructure in rural areas in order to enable operators that already own or control the “last mile”/“local loop”<sup>7</sup>, or plan to invest in local access, to provide “end-to-end” broadband connectivity to end-users. In particular, the successful bidders would have to establish an infrastructure which shall (i) enable the various electronic communications providers to connect to it in order to be able to offer to end-users broadband internet connections at a speed of at least 256/128 kbit/s (download/upload) with the possibility for higher download speeds up to 2Mb/s or more; (ii) ensure compliance with the requirements of the “Service Level Agreement”, annexed to the tender documentation; (iii) enable the functioning of VoIP services (voice communications over the Internet protocol), and (iv) provide VPN (virtual private network) functions upon the user’s request.
- (13) *Areas covered:* The notified measure covers all administrative regions of Latvia with the exception of those territories within a particular region where the broadband data transmission services with the speed corresponding to the service specifications defined in the tender (see above, point 12) are already being provided.
- (14) *Wholesale offer:* The successful bidders will be responsible for the maintenance of the infrastructure and upon request will have to grant third parties wholesale

---

<sup>6</sup> The Latvian authorities will benchmark these prices against the average prices currently available on the Latvian market for similar broadband services.

<sup>7</sup> The local loop is the last mile connection linking the final customers to the local telephone exchange.

access to the infrastructure funded under the measure. This wholesale access obligation will apply for a period of five years from the start of service provision. The principles of non-discrimination and equal treatment will apply to all such access requests. No exclusive rights whatsoever will be granted to the successful bidders. Other operators could also build in the same area(s) competing broadband infrastructures.

- (15) *Technology and infrastructure*: The measure is technologically neutral. Thus, operators can have recourse to fixed, wireless or any other technology or combination thereof for the purposes of deploying their networks.
- (16) *Beneficiaries*: The beneficiaries and direct recipients of the aid will be the successful service providers investing in broadband (backhaul) infrastructure. The latter will bear all costs in relation to the maintenance (for a period of 10 years) of the network infrastructure.
- (17) *Budget and aid intensity*: The aid is granted in the form of grants and the overall State contribution amounts to a total of € 8 152 400, with € 6 114 300 being provided by the ERDF and the remaining € 2 038 100 by the Latvian State. Although the State contribution will depend on the outcome of the tender and the individual bids, it will not exceed 35% of the total costs of the projects.
- (18) *Eligible costs*: The Latvian authorities will provide co-funding for the investment costs of putting in place the necessary backhaul broadband infrastructure. Investments in local access networks are not eligible.
- (19) *Tender process – assessment criteria*: The relevant projects will be implemented on the basis of a public-private partnership by means of an open tender organised according to the requirements of European public procurement rules. The tender is based on a score system, whereby all relevant regions will be given points from 1 to 26. Such order of priority is necessary in case there are not enough financial resources for the modernisation of broadband infrastructure for all regions.
- (20) Apart from complying with a number of technical requirements set out in the tender documentation, the selection process will be based on two main criteria. *First*, the larger the territory a bid will cover for establishing the broadband infrastructure, the higher the rating given to it, and *second*, the smaller the amount of aid a bidder will request, the higher the rating given to its proposal. Conversely, the higher the amount of private financing contributed by a bidder, the higher the rating given to its bid. Moreover, the assessment of the relevant bids will also depend on the average connection costs for local loop providers whose loops are 5 km apart from the connection point. The lower the connection cost, the higher the rating given to the particular bid. The tender will also take into account that the selected bids involve awareness-raising and demand-stimulation measures in the concerned regions.
- (21) *Monitoring*: After the completion of each project, the relevant authorities will verify by means of random inspections whether the broadband investments have been carried out in accordance with the legal provisions and the specific conditions undertaken by the operator. Moreover, for a period of five years after the completion of each project, each successful bidder will have to provide, on an annual basis, certified and audited statements showing compliance with the tender obligations.

(22) *Duration of the measure:* Aid can be granted for projects running until 31 December 2008.

#### **IV. ASSESSMENT OF THE MEASURE: PRESENCE OF AID**

(23) 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

(24) The broadband network infrastructure is financed partly by (a) European structural funds, which qualify as state resources once under the control of a Member State (budget), and partly by (b) funds from the Latvian State budget. Thus, in both cases state resources are involved.

##### Economic advantage

(25) *Eligible network operators:* The successful bidders will receive financial support which will enable them to enter the market and provide broadband network services on conditions not otherwise available on the market. Eligible operators that also control local access networks will be able to offer end-to-end services at lower prices and as a result, they will be able to attract more customers than under normal conditions.

(26) *Third party providers:* In most areas covered by the notified measure, there is no broadband infrastructure and therefore no broadband wholesale offer at all, preventing market entry of third parties such as service providers without own infrastructure. Therefore, third party providers of broadband services using wholesale backhaul connectivity built under the measure might also benefit from the State resources, as they will be customers of the eligible service providers.

(27) *End users:* The ultimate objective of the measure is to provide affordable 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 on a purely commercial basis.

##### Distortion of competition

(28) The intervention of the State alters the existing market conditions by allowing the provision of broadband services by the selected service providers and, potentially, third party providers. A number of operators might have decided to enter the market by having recourse to more expensive market-based solutions (for instance satellite or leased line offerings). Therefore, the fact that a new

broadband service becomes available at a lower price than existing albeit expensive solutions has the effect of distorting competition.

- (29) In addition, while the Latvian decided to intervene precisely in view of the lack of private initiatives in the concerned areas, it cannot be excluded that market initiatives could become viable in some areas in the medium term. By securing funding from the State, the chosen service providers will be capable of establishing their business and developing their customer base, enjoying a first mover advantage over prospective competitors.
- (30) The scheme is also selective in that it is addressed to undertakings active only certain markets for electronic communications services. These selectivity elements also induce a potential distortion of competition<sup>8</sup>.

#### Effect on trade

- (31) Insofar as the intervention is liable to affect providers of electronic communications services and service providers 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, although the importance of that effect will probably be low.

#### Conclusion

- (32) In view of the above, the Commission considers that the notified measure grants an economic advantage to the selected network providers, third party operators and final users that exercise an economic activity. The measure 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.
- (33) Having established that the measure involves aid within the meaning of Article 87(1) of the EC Treaty to the selected network 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**

- (34) The Commission notes that the measure aims to ensure the widespread availability and use of high-speed broadband services in currently underserved 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. The areas covered by the measure are located within areas eligible under the European Regional Development Fund, as well as Art. 87 (3) (a) assisted areas within the meaning of the Regional Aid Guidelines. However, 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

---

<sup>8</sup> Judgement C-143/99, *Adria Wien Pipeline*, Slg. 2001, I-8365.

third party operators and end users, for whom the benefit is not linked to any initial investment.

- (35) 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 Treaty<sup>9</sup> 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.

- (36) 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 particular, the measure shall be assessed with respect to 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?

## **1. The support of broadband rollout is in line with the common interest**

### ***Community policy***

- (37) As outlined in its Communication “i2010 – A European Information Society for growth and employment”<sup>10</sup> and the eEurope Action Plan 2005<sup>11</sup>, the Commission actively supports the widespread availability of broadband services. There is clear evidence for the regional economic development benefits resulting from greater broadband deployment, including job creation and retention as well as improved health and education services<sup>12</sup>. In order to achieve better broadband coverage and take-up, the Commission encourages Member States to put comprehensive

<sup>9</sup> 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/](http://europa.eu.int/comm/secretariat_general/sgb/state_aids/)).

<sup>10</sup> COM(2005)229 final, 1 June 2005.

<sup>11</sup> COM(2002)263 final, “eEurope 2005: An information society for all”.

<sup>12</sup> 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”.

national broadband strategies in place.<sup>13</sup> The measure at hand forms an important part of the Latvian Broadband Strategy. By improving broadband access for citizens and businesses in underserved regions of Latvia, the measure helps achieving greater cohesion and is therefore in line with the common interest.

### ***Cohesion objective and market failure considerations***

- (38) 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. It has been estimated that, in general, approximately 65-70% of the costs associated with the deployment of broadband in the access network is related to civil infrastructure<sup>14</sup>. 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.
- (39) Even if existing local access networks (such as copper loops) can be used to provide broadband services, the cost of linking national and regional backbones with the local access networks via adequate backhaul infrastructure remains very high and represents often an important barrier to the roll-out of broadband services. As a result, rural and remote areas are often deprived of broadband services since the supply of these services is not economically viable without public support.
- (40) Hence, by providing financial support for the establishment of backhaul infrastructure to offer broadband services to end-users in underserved regions of Latvia, the authorities pursue genuine cohesion and economic development objectives.

## **2. Well-designed aid**

### ***(a) Aid is the appropriate instrument***

- (41) The proposed State funding is part of an integrated set of measures under the Latvian national broadband strategy and will be combined with other instruments such as regulatory measures and information campaigns for end users.
- (42) On the supply side, it could be argued that tariff and access regulation imposed by the Latvian regulator is another instrument of state intervention. However, *ex ante* regulation, although necessary, is not a sufficient instrument to enable the supply of broadband services in rural and remote regions. In particular, without adequate backhaul connectivity, entry into the local access market is, as explained above, either impossible or very expensive. Likewise, alternative providers need to combine the use of (regulated) wholesale products from the incumbent (full or

---

<sup>13</sup> Commission Communication COM(2004) 369 of 12.05.2004, "Connecting Europe at High Speed – National Broadband Strategies".

<sup>14</sup> Broadband Stakeholders Group "Broadband in Rural Areas", 2003.



shared local loop unbundling) with own network investments which may not be profitable in areas where demand is low.

- (43) On balance, in view of the limited availability of broadband in rural and remote areas of Latvia, the Commission considers that the development of broadband infrastructure by means of State co-financing is an appropriate instrument to achieve the set objectives.

***(b) The aid provides the right incentives to operators***

- (44) The State co-financing provides a significant and direct investment incentive for the operators benefiting from the measure to roll out broadband backhaul infrastructure. According to the Latvian authorities, network operators have already expressed a high degree of interest to submit projects under the notified measure.

***(c) Proportionality***

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

- (a) State funding is provided on the basis of an open tender:* The tender is based on the national public procurement rules which in turn are based on the requirements of openness, transparency and non-discrimination. Consequently, any operator which fulfils the requirements of the tender may participate. The tender, seeking the economically most advantageous proposal, will be designed to minimise the cost of investment and the associated public funding, whilst still ensuring an appropriate level of service.
- (b) Wholesale access:* Given that the notified measure only provides aid in areas where broadband infrastructure is not yet available, most beneficiaries will be deemed to have a privileged position for wholesale broadband services in the specific areas concerned once the infrastructure is in place and the provision of services starts. Although not necessarily having significant market power within the meaning of Article 7 of the Framework Directive<sup>15</sup>, such operators will still be required to provide wholesale access to third parties for a period of 5 years.
- (c) Technological neutrality:* The measure is technologically neutral, i.e. it does not favour a priori any given technology. Successful bidders may decide to deploy fixed or wireless technologies or any combination thereof.
- (d) Limited aid amounts:* The eligible operators are expected to contribute a sizeable amount of the total investment costs. Public financing is limited to a maximum of 35% of the total costs of each project. Moreover, the less state funding a bidder will request, the more favourable the assessment of its bid will be.

---

<sup>15</sup> Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services.

- (e) *Duration:* Whilst the measure aims at ensuring sustainable solutions, the funding will be provided only for a limited amount of time, for projects running until 31.12.2008.
- (f) *Monitoring:* Comprehensive mechanisms are put in place to ensure the ex-post monitoring of the broadband investments and the fulfilment of the tender requirements by the successful bidders.

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

- (46) 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 ultimate objective is to enable both businesses and citizens to avail themselves of affordable broadband services.
- (47) In view of the characteristics of the measure, the overall impact on competition is deemed to be positive. On the effect on trade, the Commission does not identify negative spill-overs for other Member States.
- (48) The Commission therefore considers that the overall effect of the measure to support investments in broadband infrastructure to enable the provision of broadband services in underserved regions of Latvia is deemed to be positive. The measure is also 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 economic 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.

**Conclusion**

- (49) 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 entitled “Development of broadband communication networks in rural areas” is compatible with Article 87(3)(c) of the EC Treaty.

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://europa.eu.int/comm/secretariat\\_general/sgb/state\\_aids/](http://europa.eu.int/comm/secretariat_general/sgb/state_aids/).

Your request should be sent 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