

Citynet Amsterdam: an application of the market economy investor principle in the electronic communications sector

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1. Introduction

Broadband networks are considered to be the key infrastructure of the knowledge economy. Access to broadband services has become vital for businesses and citizens to share information, communicate and work instantly with anyone, anywhere in the world. The availability of broadband is reshaping sectors such as media, entertainment or retail banking. Thanks to the investments and business drive of private operators and a successful regulatory framework, broadband services are available today to most European citizens. However, it is not only private operators that invest in broadband networks: public authorities engage in support schemes and measures to widen broadband coverage and bring more affordable services to citizens. Their involvement has raised a number of questions, especially with regard to the application of the State aid rules.

Under the EU State aid rules, investments by public authorities in companies carrying out economic activities can be considered not to involve State aid if the investments are made on terms that a private investor operating under market conditions would have accepted. This is known as the ‘market economy investor principle’ — ‘MEIP’ — or ‘private investor principle’⁽²⁾. However, this is rarely the case for investment in broadband networks, since public authorities generally take action precisely because the market fails to deliver the desired services⁽³⁾. Nevertheless, it may still

be the case that a public investment in a broadband project is capable of securing revenues that are sufficient to repay its costs within a reasonable timeframe and provide a rate of return in line with the market remuneration for projects of similar risk⁽⁴⁾.

In a recent case in the electronic communications sector concerning the roll-out of a high-speed broadband fibre access network in the Dutch city of Amsterdam⁽⁵⁾, the Commission shed some light on the application of the MEIP in this sector. The Citynet Amsterdam project was the first broadband measure assessed under the State aid rules for which the national authorities argued that the public funds provided did not constitute State aid because the investment was pursued on market terms. This article provides a short overview of the case and elucidates a number of general policy considerations.

2. The ‘Citynet Amsterdam’ project

The case concerned the construction of a ‘Fibre-to-the-Home’ broadband access network⁽⁶⁾ connecting 37 000 households in Amsterdam⁽⁷⁾, which are already served by several competing broadband networks.

The Amsterdam municipality invested in the passive layer of the network⁽⁸⁾ along with two private investors and five housing corporations.

⁽¹⁾ Directorate-General for Competition, unit C-4 and Task Force on Pharmaceuticals Sector Inquiry. The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors

⁽²⁾ See also Hans W. Friederiszick and Michael Tröge: Applying the Market Economy Investor Principle to State Owned Companies — Lessons Learned from the German Landesbanken Cases, Competition Policy Newsletter 2006, Number 1 — Spring.

⁽³⁾ For instance, network industries are typically characterised by high fixed costs. As a result, it is generally more profitable to roll out broadband networks where potential demand is higher and more concentrated. Therefore, in certain areas, operators may have no commercial incentive to invest in broadband services: the high additional costs are not matched by additional revenues. In such cases, State aid might be justified under certain conditions in order to provide broadband access to all citizens at affordable prices.

⁽⁴⁾ See also Monika Hencsey, Olivia Reymond, Alexander Riedl, Sandro Santamato and Jan Gerrit Westerhof: State aid rules and public funding of broadband, Competition Policy Newsletter 2005, Number 1 — Spring.

⁽⁵⁾ Commission Decision of 11 December 2007 in Case C 53/2006 *Citynet Amsterdam — investment by the city of Amsterdam in a fibre-to-the home (FttH) network*, not yet published.

⁽⁶⁾ ‘Fibre to the Home’ is a form of fibre-optic communication network in which an optical fibre runs up to the customers’ home. Fibre networks — when compared with existing copper-based broadband networks (such as ADSL or cable) — provide much higher speeds and symmetrical services and are expected to pave the way for the mass-market application of numerous internet-based services such as IPTV, video on demand and telemedicine.

⁽⁷⁾ The notified project comprises approximately 10% of all households in the city of Amsterdam.

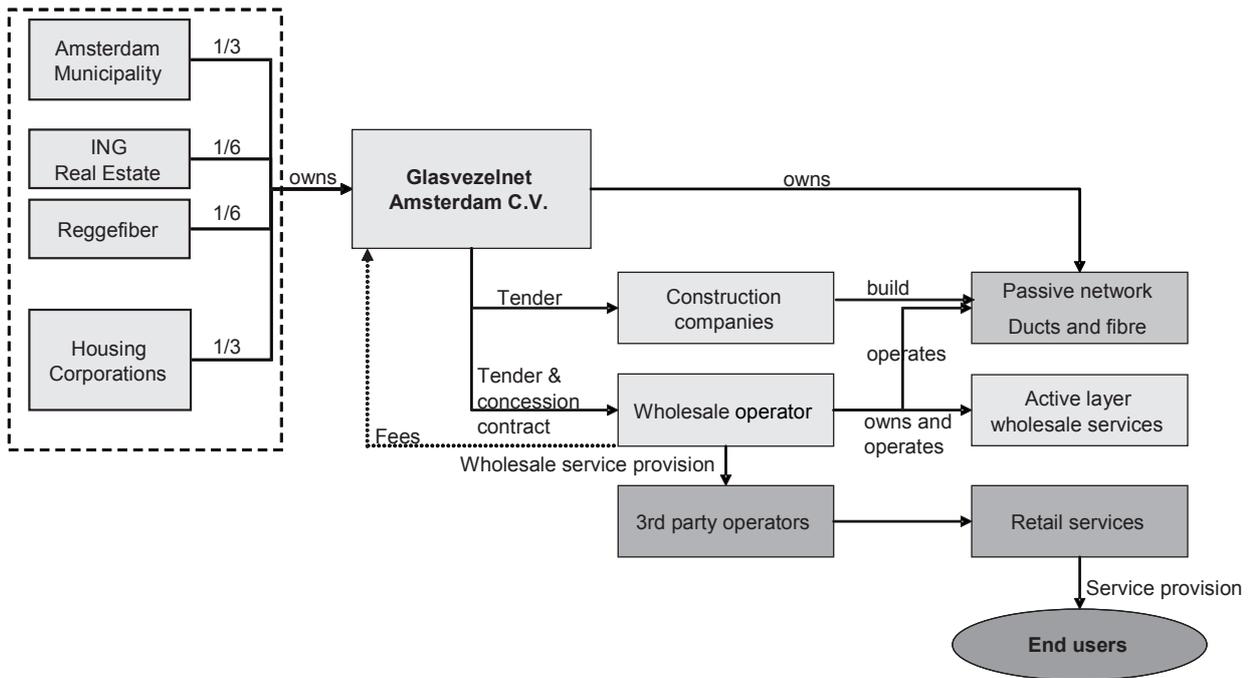
⁽⁸⁾ The passive layer includes ducts, fibre and street cabinets. The active layer includes the management, control and maintenance systems necessary to operate the network, such as switches, routers or splitters.

The passive infrastructure is owned and managed by Glasvezelnet Amsterdam cv ('GNA'). The Amsterdam municipality owns one third of GNA's shares, ING Real Estate and Reggefiber (two private investors) together own another third, while five housing corporations hold the remaining third. The total equity investment in the project amounted to €18 million.

The wholesale commercial operator of the new fibre network was selected through a tender procedure and provides open, non-discriminatory access to retail commercial operators that offer TV, broadband and telephony services on the new fibre network.

The project setup is depicted in the figure below.

Figure 1 — Overview of the project



3. State aid assessment

The criteria of the market economy investor principle

Contrary to previous broadband cases ⁽⁹⁾ where the State aid compatibility assessment was the central issue, the main question in this case was whether State aid was present at all, i.e. whether or not the investment by the municipality of Amsterdam would be acceptable to a private investor under normal market conditions and therefore in line with the MEIP.

Four main criteria can be deduced from the Commission's approach in previous decisions and the Court's case law in assessing whether a private investor would participate in a given project

under the same terms and conditions as the public authorities ⁽¹⁰⁾:

- *First*, it has to be determined whether the participating investors are market investors and whether the investments by the private investors have real economic significance. Such significance should be assessed in absolute terms (in relation to the total investment) and in relative terms (in relation to the financial strength of the private investor concerned).

⁽⁹⁾ See for instance Cases N 475/2007 *National Broadband Scheme Ireland*, Commission decision of 25.9.2007; N 473/2007 *Broadband connections for Alto Adige*, Commission decision of 11.10.2007; N 570/2007 *Broadband in rural areas of Baden-Württemberg*, Commission decision of 23.10.2007 or C 35/2005 *Broadband development Appingedam*, Commission decision of 19.7.2006. All decisions are available at the following website: http://ec.europa.eu/comm/competition/state_aid/register/iii/.

⁽¹⁰⁾ See for instance judgment of the Court of 8 May 2003 in Joined Cases C-328/99 and C-399/00 *Italian Republic and SIM 2 Multimedia SpA v Commission* [2003] ECR I-4035 ('Seleco judgment'), paragraphs 37-38; Joined Cases 296 and 318/82 *Netherlands and Leeuwarder Papierwarenfabriek BV v Commission* [1985] ECR 809, paragraph 17; Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State aid in the aviation sector, OJ C 350, 10.12.1994, p. 5, points 25 and 26; Commission Decision of 2 August 2004 (2006/621/EC) *on the State aid implemented by France for France Télécom*, OJ L 257, 20.9.2006, pp. 11-67; Communication of the Commission to the Member States 93/C 307/03 *on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector*, OJ C 307, 13.11.1993, p. 3, paragraph 2.

- *Second*, it has to be assessed whether the investment by all parties concerned take place at the same time.
- *Third*, it has to be ascertained whether the terms and conditions of the investment are identical for all shareholders.
- *Fourth*, in cases where the State, other investors or the beneficiary have other relationships outside this investment (for example through a side-letter, providing for a guarantee by the State), there may be grounds for doubting whether such equivalence in the mere investment terms suffices ⁽¹¹⁾.

The Commission's assessment

Operations of public authorities in the liberalised electronic communications sector have to be analysed carefully because of the potential distortion caused by State aid. This is especially relevant for metropolitan areas where private operators are offering services over several platforms at generally affordable prices due to competition. Given the Dutch authorities' failure to provide all the documents necessary for the Commission to assess the measure fully and the submissions of two complainants raising serious doubts about the project, the Commission opened an in-depth investigation in December 2006 and gave all interested parties an opportunity to submit their observations ⁽¹²⁾.

As a result of the investigation, the Commission came to the conclusion that the participation and involvement of the Amsterdam municipality in the project was akin to that of a market investor. In its assessment, the Commission paid particular attention to the following elements:

- *First*, two private companies active in the sector ⁽¹³⁾ participated in the project with significant investments and on equal terms with the municipality. Furthermore, the shareholding structure of GNA ensured that no single shareholder could exert sole control over the company.
- *Second*, although the Amsterdam municipality carried out certain limited pre-investment

activities before the formal setup of GNA, this was not enough to call into question the fulfilment of the timing criterion given that there was agreement among all shareholders that the municipality of Amsterdam would have to be reimbursed later on for these pre-investments.

- *Third*, all shareholders in GNA had invested under the same terms and conditions. In particular, in the event of underperforming business all investing parties would have to bear any losses proportionally to their stake in the venture.
- *Fourth*, the investigation did not reveal any other relationships between the private shareholders and the municipality which could have called into question the application of the MEIP.

Together with the detailed analysis of the business plan, which was also accepted by the private investors, these elements provided sufficient evidence for the Commission to conclude that the investment of the public funds was in line with the MEIP and therefore did not constitute State aid. The Commission approved the project under the EC State aid rules on 11 December 2007.

4. Preliminary policy considerations

The Commission has so far assessed about 35 public support measures for broadband services and networks under the State aid rules. In 'black areas' characterised by adequate broadband coverage over several competing broadband infrastructures (cable, ADSL, etc.), such as Amsterdam, the justification for State aid is doubtful as there is a high risk that State involvement crowds out existing and future private investments ⁽¹⁴⁾. However, in the case of Amsterdam, the municipality participated in the project like a private investor and on equal terms with two private investors and no State aid was present.

There is a clear, contextual difference between the Commission's earlier negative decision in the Appingedam case ⁽¹⁵⁾ and the Amsterdam decision. Although both projects were initiated in the

⁽¹¹⁾ In other words, the terms and conditions can be identical in one agreement but, at the same time, other agreements can lay down additional clauses with different rights and obligations.

⁽¹²⁾ Opening decision of 20 December 2006 in Case C 53/2006 (ex N 262/2005) *Citynet Amsterdam — investment by the city of Amsterdam in a fibre-to-the home (FttH) network*, OJ C 134, 16.6.2007, p. 9.

⁽¹³⁾ ING RE is a subsidiary of ING, a financial services (banking and insurance) conglomerate active, among other things, in communication infrastructure investments, while Reggefiber is engaged in several fibre network projects in the Netherlands.

⁽¹⁴⁾ In its decisions on public support for broadband projects, the Commission distinguishes between 'white', 'grey' and 'black' areas when carrying out the compatibility assessment in the presence of aid. The Commission has on several occasions classed as compatible aid public support in areas where adequate broadband services are unavailable or available in a limited way (so-called 'white' or 'grey' areas) on the ground that the aid has no or only a limited distortive effect. See also footnote 9.

⁽¹⁵⁾ C 35/2005 *Broadband development Appingedam*, Commission decision of 19.7.2006, which was the Commission's first negative decision as regards public funding of broadband projects.

so-called 'black area', and both projects concerned the deployment of fibre networks, the settings of the two projects were different. Unlike Amsterdam, the Appingedam municipality did not argue that its investment was in line with market terms and that there were no private investors involved in the network infrastructure. The Commission found that the project in Appingedam involved State aid and was incompatible with the common market as several market operators were already providing broadband services. In comparison, in Amsterdam, the Commission found that the municipality participated in the project like a market investor. Accordingly, this meant that there was no State aid involved in the Amsterdam project and that there was no need for the Commission to carry out a compatibility assessment.

It is important to stress that the Commission took care to underline that it is not sufficient for public

authorities to engage in projects merely by claiming that they are acting like a private investor. The conformity of a public investment with market terms has to be demonstrated thoroughly and comprehensively, for instance by means of significant participation of private investors and the existence of a sound business plan. In addition, as stated in the Amsterdam decision, the private parties would have to assume the commercial risk linked to the investment under the same terms and conditions as the public investor.

As public support for broadband schemes moves from support for basic broadband in rural areas towards support for 'next-generation networks' in areas where broadband services are already provided by several operators, the Commission will continue to verify that public involvement addresses first and foremost genuine market failures and does not crowd out private investment.