

Case No: 72904
Event No: 661749
Dec. No: 444/13/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 13 November 2013

on the deployment of a Next Generation Access network in the municipality of Skeiða-
and Gnúpverjahreppur

(Iceland)

The EFTA Surveillance Authority (“the Authority”),

HAVING REGARD to:

The Agreement on the European Economic Area (“the EEA Agreement”), in particular Article 61(3)(c) and Protocol 26,

The Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (“the Surveillance and Court Agreement”), in particular Article 24,

Protocol 3 to the Surveillance and Court Agreement (“Protocol 3”), in particular Article 4(3) of Part II,

WHEREAS:

I. FACTS

1. Procedure

- (1) By letter dated 28 November 2012 (Event No 655350), the Icelandic law firm Acta lögmannsstofa lodged a complaint on behalf of the company Ábótinn ehf. (“Ábótinn”)¹ with the EFTA Surveillance Authority (“the Authority”) concerning allegedly unlawful state aid granted by the municipality of Skeiða- and Gnúpverjareppur (“the Municipality”)

¹ Also referred to interchangeably herein as “the complainant”.

and the state-owned energy company, Landsvirkjun, for the deployment of a Next Generation Access (“NGA”) network.²

- (2) By letter dated 18 December 2012 (Event No 656852), the Authority requested additional information from the Icelandic authorities. By letter dated 24 January 2013 (Event No 660810), the Icelandic authorities replied to the request and provided the Authority with the relevant information.
- (3) By letter dated 16 April 2013 (Event No 668299), the Authority requested further information and clarification from the Icelandic authorities which they provided by letter dated 16 May 2013 (Event No 672572).

2. The complaint

- (4) The complainant, Ábótinn, is an internet service provider (“ISP”)³ which was founded in 1997 and has been supplying broadband and internet connections in southern Iceland since 2001. In 1997 the complainant started rolling out its own broadband network in the village of Árnes in the Municipality.⁴ According to the complainant, no other companies have been interested in investing in broadband infrastructure in this rural area.
- (5) The complainant claims further that unlawful state aid is being provided by the Municipality and Landsvirkjun to Fjarskiptafélag Skeiða- og Gnúpverjahrepps (“FSG”) in order to construct and operate a fibre-to-the home (“FTTH”) network⁵ in the Skeiða- and Gnúpverjareppur area and to provide connections for undertakings that will provide end services to residents and companies (“the project”). According to the complainant, the construction of the NGA network will result in the loss of resources that Ábótinn has invested in broadband construction in this area. Furthermore, the complainant claims that FSG has made binding exclusivity agreements with the local residents who wish to utilise the new network, effectively eliminating Ábótinn’s business in the area based on its own network infrastructure.
- (6) According to the complainant, the entire Skeiða- and Gnúpverjareppur area should be considered a black area within the meaning of Chapter 3.3.3 of the Authority’s 2013 guidelines concerning the application of state aid rules in relation to rapid deployment of broadband networks (“the Broadband Guidelines”).⁶ The complainant therefore maintains that funding of the construction of an additional broadband network in the area would lead to an unacceptable distortion of competition and the crowding out of private investors.

² Next generation access or NGA refers to broadband access networks (such as those involving optical elements) that are capable of delivering services with enhanced characteristics (e.g. higher throughput) compared to existing (current generation) local access infrastructure or technologies (such as those based on traditional copper infrastructure).

³ Providers of telecommunications services are also referred to interchangeably herein as “service providers” or “telecommunications service providers”.

⁴ According to the complainant, Ábótinn offers five types of internet connections. These are Wi-Max, Fibre, Wi-Fi, AirMax and ADSL.

⁵ FTTH refers to a broadband network architecture whereby the final connection to the end user’s home or premises is optical fibre. Optical fibre refers to a technology that uses glass (or plastic) threads (fibres) to transmit large amounts of digital information over long distances using light. Optical fibre or fibre-optic technology can be used to transmit signals for broadband, TV and voice.

⁶ The Authority’s guidelines on the application of state aid rules in relation to rapid deployment of broadband networks (“the Broadband Guidelines”) are available on its website at <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>.

- (7) The complainant further reviews the relevant conditions for examining whether or not a measure qualifies as state aid under the first paragraph of Article 61 of the EEA Agreement and concludes that all relevant conditions are fulfilled for the measure to involve state aid. The complainant also concludes that the alleged aid measure does not qualify for any of the relevant exemptions and therefore must be considered incompatible with the EEA Agreement.

3. Description of the measure

3.1 Background

3.1.1 General

- (8) Before describing the substance of the complaint, it is appropriate to review the background to the disputed measure.
- (9) Iceland has a very distinct population distribution with the majority of the population located in the greater Reykjavík area. As at 1 January 2013, Iceland had a population of 321,857 and a total landmass of 103.000 km² making it the most sparsely-populated country in Europe.⁷ The majority of Icelanders, around 63% of the total population, live in the greater Reykjavík area and the rest of the population resides in small towns and villages scattered around the coast of Iceland.
- (10) Broadband deployment in Iceland is considered of high importance for the country's economic development and the Parliamentary Resolution on a Telecommunications Strategy for the years 2011-2022 sets out the goal that 99.9% of residential and business premises will have high-speed internet access by the year 2022.⁸ Furthermore, the importance of community intervention when providing efficient network access in certain rural areas of Iceland has been highlighted by the Icelandic Post and Telecom Administration ("PTA"), as evidenced by its 2011 annual report:⁹

"In rural areas there is less competition and the interest of the parties to the market for development is unclear, particularly in sparsely populated regions. This means that at many locations fibre-optic cables will need to be laid on a community basis. If matters are properly handled, there is no reason that electronic communications companies should not be able to compete with their services at all locations in the country on such networks. In the electronic communications plan presented to the Althingi in the autumn of 2011 the objective is set to reach 100 Mb/s in almost all of the country's households by the year 2022. The development of electronic communications networks will thus be one of the main community projects for the state, municipalities and the electronic communications companies for the next decade."

3.1.2 Skeiða- and Gnúpverjahreppur ("the Municipality")

- (11) Skeiða- and Gnúpverjahreppur is a municipality in the south of Iceland, covering an area of 2.231 km² and situated in the northeast of Árnæssýsla, between Hofsjökull in the north, Flóahreppur in the south, Þjórsá in the east and Stóra-Laxá in the west. The following map shows the geographic location of the Municipality:¹⁰

⁷ Statistics Iceland, Statistical Series: Population 2013:1, 9.4.2013, report available online at: <http://www.statice.is/lisalib/getfile.aspx?ItemID=14991>.

⁸ Parliamentary resolution on a twelve-year telecommunications strategy from 2011 to 2022, doc 593 case 172.

⁹ Post and Telecom Administration in Iceland Annual report 2011, p. 8, available online at: http://www.pfs.is/upload/files/PTA_Iceland_Annual_Report_2011.pdf

¹⁰ Map available online at: <http://www.sudur.is/sidur/skeida-og-gnupverjahreppur>.



- (12) As of 1 August 2012, there were 505 inhabitants in the Municipality, comprising 172 households. There are two small villages in the Municipality, namely Brautarholt and Árnes, with about 15 households each and a total population of about 85 people. The Municipality is otherwise rural and sparsely populated. The main areas of business activity in the Municipality are farming, education, travel services and trade.
- (13) According to Act No 13/2011 on Municipalities, Iceland is divided into several municipalities.¹¹ The municipalities are governed by Municipality Councils that are elected by the inhabitants of the municipality, in accordance with Act No 5/1998 on the election of Municipality Councils.¹² In Article 3(1)(1) of Act No 138/2011 it is stated that municipalities are independent authorities that are governed by democratically-elected councils and in Article 8 of the Act it is stated that the Municipality Council governs the municipality. It is further stated that the Municipality Council has the power to decide on the municipality's income allocation, loans and disposal of property.

3.1.3 *The Agreement between Skeiða- and Gnúpverjahreppur and Landsvirkjun*

- (14) On 26 June 2008, the Municipality and Landsvirkjun entered into a Framework Agreement concerning the preparation, construction and operation of the Hvammur-, Holta- and Urriðafoss hydroplants. The Agreement includes, *inter alia*, a provision stating that Landsvirkjun is to finance the infrastructure necessary for the construction and operation of the three hydro plants, such as road improvements, the construction of an information centre and improvements to broadband connections in the area.
- (15) According to Article 3 of the Framework Agreement, Landsvirkjun and the Municipality would cooperate on a plan to construct wireless internet connectivity (WiMax)¹³ for the entire Municipality. The construction of an improved broadband network in the Municipality was seen as being in the interest of both parties. However, according to the

¹¹ See Act No 138/2011 on Municipalities, of 28.10.2011.

¹² See Act No 5/1998 on the election of Municipality Councils, of 6.3.1998.

¹³ WiMax stands for Worldwide Interoperability for Microwave Access and involves the use of wireless access for the transmission of communications services to individual homes or business premises, but with a longer range than Wi-Fi allowing greater distances to be covered. See footnote 19 for a definition of Wi-Fi.

Agreement, Landsvirkjun's participation in the network construction would be confined to the roll-out of a fibre-optic cable to three designated transmitters, the construction of equipment shelters for the transmitters and the construction of masts. All other costs relating to technical equipment and operations would be borne by the Municipality.

- (16) Recommendations for revisions and a project description were to be finalised before May 2008 and the parties would then enter into an agreement concerning the initial capital expenditure. It was foreseen that, although the Municipality would own the network, it would tender out its operation after having consulted with the Telecommunications Fund (i. Fjarskiptasjóður).¹⁴

3.2 The planning of the project

3.2.1 Early preparations

- (17) Project discussions first started in October 2010. On 5 October 2010, the Municipality Council discussed the status of telecommunications in the Municipality.¹⁵ Representatives of Fjarski ehf. ("Fjarski"), a telecommunications company, attended this meeting and presented technical possibilities for connectivity in the area. At a meeting on 26 October 2010, the Municipality's Employment, Communications and Transport Committee discussed the possibility of rolling out fibre-optic cable.
- (18) On 16 June 2011, a draft contract between Landsvirkjun and Fjarski regarding an assessment of rolling out fibre-optic cable in the Municipality was presented to the Municipality Council. The Council decided that 6 million ISK of Landsvirkjun's contribution to the Municipality, based on the Agreement between the parties from 28 June 2008, should be spent on exploring possible paths for fibre-optic cable in the area.
- (19) On 7 February 2012, the Municipality Council decided to entrust the parties, which had been exploring possible paths for fibre-optic cable roll-out, with the task of contacting landowners and getting their consent to lay down the ducts. At a meeting of the Municipality Council on 10 April 2012, the fibre-optic cable project was discussed and the Council decided to seek the assistance of a local engineering firm, Verkfræðistofa Suðurlands, to prepare tender documents.
- (20) On 24 April 2012, the Municipality Council held a meeting where the project was discussed further. It was reported that all landowners had given their permission for the roll-out of fibre-optic cable on their land, and that 147 users wanted to make use of the connection. Only two were not interested. Subsequently, it was decided that the chairman of the Municipality Council should look into the option of establishing a company with the mandate of installing and operating a fibre-optic cable in the Municipality. The aim was to connect all homes and businesses in the Municipality, that had requested a connection to a NGA network, with fibre-optic cable that would make high-speed broadband available to all of the inhabitants.

¹⁴ The Fund was established by Act No 132/2005 on the Telecommunication Fund of 20.12.2005, and its role, as established by statute, is to promote development in the field of telecommunications in Iceland as described in the official Telecommunications Strategy approved by *Althingi*.

¹⁵ The minutes of the Municipality Council meetings are available online at: http://www.skeidgnup.is/sidustu_fundargerdir/.

3.2.2 Fjarskiptafélag Skeiða- og Gnúpverjahrepps (“FSG”)

- (21) The decision to establish a special purpose vehicle company (“SPV”) to install and operate fibre-optic cable in the Municipality was taken by the Municipality Council on 12 June 2012. The following decision was adopted by the Council:¹⁶

“The founding of a company that shall construct and operate a fibre optic for the Municipality of Skeiða- and Gnúpverjahreppur. There is a unanimous agreement to found such a company and its name shall be Fjarskiptafélag Skeiða- og Gnúpverjahrepps. The capital stock shall amount to 50 million ISK and shall be covered by the Municipality Treasury. The chairman of the Municipality Council and the District Manager shall be tasked with further outlining the structure of the company.”

- (22) In accordance with Act No 13/2011 on Municipalities, the decision of the Municipality Council is legally binding. FSG’s mandate is defined in the decision itself and the articles of association, where it is stated that FSG shall be established to install and operate fibre-optic cable in the Municipality. The total cost of the project was estimated at 175 million ISK. The Municipality contributed 50 million ISK, Landsvirkjun contributed 101 million ISK and FSG took a loan to fund the remaining 24 million ISK. Although FSG is expected to generate a nominal profit of around 917.000 ISK per year, it is not operated as a profit-generating entity. The vast majority of FSG’s income will go towards maintenance of the network and its administrative costs.
- (23) FSG was established by the Municipality on 12 June 2012. According to the articles of association, the main activity and purpose of the company, in line with the mandate set out in the Municipality Council decision, is the installation and operation of fibre-optic cable in the Municipality. All of the shares in FSG are owned by the Municipality. The total share capital of the company is 50 million ISK, which was covered by the Municipality when FSG was founded. Furthermore, the Board Members of FSG are all members of the Municipality Council.

3.2.3 Existing broadband in the area

- (24) Due to the fact that the Municipality is very rural and sparsely populated, few telecommunications service providers have offered services to homes and companies in the area. Ábótinn is the main service provider in the area with about 80% market share. However, according to the Icelandic authorities, Ábótinn only offers limited services of low-speed internet connections to a portion of the Municipality and does not have any plans to upgrade existing broadband infrastructure. Moreover, the Icelandic authorities note that large internet service providers in Iceland have not shown any interest in improving the internet connections in the area. Further, it became clear to the Municipality Council from discussions with those companies that they had no plans to invest in NGA infrastructure in the Municipality in the near future.¹⁷

¹⁶ Unofficial English translation by the Authority. The original Icelandic versions of the minutes of the Municipality Council meeting are available online at:

http://www.skeidgnup.is/sidustu_fundargerdir/meetings/357/Sveitarstjrnarfundur-nr.-32-12.06.2012.

¹⁷ According to the Icelandic authorities, the largest telecommunications provider in Iceland, Síminn hf., was approached on several occasions to see whether the company had any plans to improve internet connections in the Municipality. However, the company showed no interest in developing a new broadband network in the area.

- (25) The Icelandic authorities specify further that, prior to the construction of the FSG network, there were two options available to the inhabitants of the Municipality with regard to internet connections. These are described as follows:
- (i) *ADSL connections*:¹⁸ Ábóttinn had set up ADSL equipment in Árnes and Brautarholt and offered its customers ADSL connections using that equipment in conjunction with the copper lines of Míla hf. However, according to the Icelandic authorities, the limitations of this service were twofold. Firstly, these connections could only be provided to homes where the copper line from the telephone exchange to the home was less than 500 metres long. Secondly, the service was limited to internet services as it was not possible to provide television services through this type of connection. Furthermore, only about 10% of the inhabitants of the Municipality live within 500 metres of the telephone exchanges in Árnes and Brautarholt and could use the ADSL connections. According to the Icelandic authorities, the homepage of Ábóttinn specifies that the download speed of ADSL connections can be up to 8 Megabits per second (“Mbps”).
 - (ii) *Wi-Fi and WiMax connections*:¹⁹ The inhabitants of the Municipality had the option of buying wireless internet services from a few service providers, including Fjarskiptafélag Suðurlands, Emax and Ábóttinn. According to the Icelandic authorities, the services of those providers were limited to internet services only with speeds of up to 4Mbps, when conditions are optimal. However, according to the Icelandic authorities, the quality and speed of those connections varies a lot, depending on weather conditions and the distance from the transmitter to the user.
- (26) Based on the above information from the Icelandic authorities, it appears that the available ADSL broadband services were thus restricted in scope and did not reach all of the homes and businesses of the Municipality. Furthermore, according to the Icelandic authorities, the quality of the wireless transmission was poor, especially for users located far from the transmitters. The weather also worsened the quality of the connections. Therefore, the Icelandic authorities have confirmed that existing broadband availability in the area was limited and there were no NGA networks available to the inhabitants.
- (27) Having established that ISPs had no plans to improve the internet connections in the area, representatives of the Municipality Council visited every home in the Municipality to check if the inhabitants were interested in having fibre-optic cable rolled out to their premises. All homes and businesses were interested in having an FTTH connection.

3.2.4 *The tender procedure and the selection of the successful bidders*

- (28) After preparing a project description, including details of locations to be connected to the network, technical specifications and a cost analysis, the Municipality issued two calls for tender in cooperation with Verkfræðistofa Suðurlands.²⁰ The *first* concerned the laying down of ducts and the *second* concerned the blowing of fibre-optic cable into the ducts.

¹⁸ ADSL stands for Asymmetric Digital Subscriber Line. Digital Subscriber Line (DSL) technologies use traditional (fixed) copper telephony networks to deliver digital broadband signals.

¹⁹ Wi-Fi refers to the use of local radio links for the transmission of voice and data communications to individual homes or business premises. WiMax also refers to wireless communications technology but has a longer range than Wi-Fi (see footnote 13 above).

²⁰ The documents for the tenders were prepared by Verkfræðistofa Suðurlands. Information on the opening of the tenders is available at their home page:
http://www.verksud.is/vs/index.cfm?page=utbod_op&hl=utb.

- (29) There were nine bids for the *first* project, concerning the laying down of about 145 km of ducts. The bids were opened on 7 May 2012. They were as follows:²¹

Bidder:	Offer: (Total price - ISK)
Ingileifur Jónsson ehf.	89.201.900 kr.
Árni ehf.	116.720.500 kr.
Pórsverk ehf.	99.967.800 kr.
RBG-Vélaleiga og verktakar.	73.704.000 kr.
Línuborun og Austfirskir verktakar	123.040.500 kr.
Grafan ehf.	108.312.400 kr.
GV-Gröfur	149.399.770 kr.
Nesey ehf.	123.000.00 kr.
Þjótandi ehf.	85.241.660 kr.

- (30) As the Municipality's cost estimate was ISK 116.852.771, the lowest bids were considerably lower than what the Municipality had predicted. After processing the bids, the Municipality entered into an agreement with Þjótandi ehf. which was found to have the best valid bid.
- (31) For the *second* project, concerning the blowing of cables into the ducts, there were six bids. They were as follows:

Bidder:	Offer: (Total price - ISK)
1) Tengir hf.	31.000.000 kr.
2) Ljósverkinn ehf.	39.995.967 kr.
3) SH leiðarinn ehf.	23.322.700 kr.
4) Ljósþing ehf.	36.842.180 kr.
5) TRS ehf.	34.766.629 kr.
6) Rafal ehf.	31.326.467 kr.

- (32) The winning bid was submitted by SH leiðarinn ehf. The bid was more than 15 million ISK lower than the Municipality's own cost estimate, which was 39.336.500 ISK. The tender procedure was open and transparent and the tender description as well as information on the opening of tenders was published online at the Verkfræðistofa Suðurlands home page.²²

3.3 Network construction

3.3.1 General

- (33) The rollout of approximately 145 km of ducts commenced on 18 July 2012. After the ducts had been laid down, the second contractor blew the fibre-optic cable into the ducts. The construction of the network was finished in January 2013.
- (34) Following completion of the network construction, third-party service providers started selling their services using the new network. In April 2013, of the 171 households that had the fibre-optic cable installed to their houses, 136 (or 79.53%), had already chosen a service provider and started to purchase services across the newly-installed network. Of the 27 companies that had the fibre-optic cable installed, 19 (or 70.37 %), had already

²¹ There was one invalid bid, from Steypustöð Skagafjarðar, that was not opened.

²² <http://www.verksud.is/>.

chosen a service provider and started to purchase services across it. Of the 31 summer homes that had the fibre-optic cable installed, 7 (or 22.58%), had already chosen a service provider and started to purchase services across it.

3.3.2 *Technical description of the project*

- (35) The network layout is designed in the shape of two stars. Each home, company or summerhouse that asks for a connection is connected to a centre by two fusion-spliced fibre-optic cables. There are telecommunications cabinets in each centre. One of the cabinets holds connections for users and three other cabinets are used for the service providers' equipment. Trunk lines connect the user cabinet to the other three cabinets.
- (36) Connections to each home are up to 20 km long from the point of presence ("POP") with a single-mode fibre-optic cable of the type G.652D blown into the ducts. There are 73 manholes in the network where connections to the homes are connected with the main cable. In each home a connection box is installed inside the house where the cable is connected and ready for use. From each house there are two cables to the POPs. This was done to give the users the option of buying different services from different service providers (*e.g.* television services from one service provider and telephone and internet services from another service provider). There are two POPs in the system. Service providers are able to place their telecommunications equipment in the POPs to connect to homes and businesses in the Municipality via the fibre-optic cables.
- (37) The speed of data transfer through the fibre-optic cables is very fast. Initially, it was assumed that the data transfer speed to each home would be 100Mbps, but according to the Icelandic authorities, the system could at the outset transfer 1000Mbps (1Gbps) to each user. The speed of the data transfer is controlled by the equipment the service providers install to connect to the users. FSG will only own and run the dark fibre. The company will not run active equipment²³ or customer premises equipment ("CPE").
- (38) The three service provider cabinets are open to all service providers that are interested in selling their services over the network. Service providers supply their services to each user through one fibre-optic cable. Users can choose to buy different services from two service providers. In those cases, each service provider receives one fibre and installs their own end-user equipment. According to the authorities, a number of users have chosen to buy services from more than one service provider.

3.3.3 *Access to the network*

- (39) According to the Icelandic authorities, the network is designed to be passive, neutral, open and available to all interested operators across all sectors with all possible forms of network access.
- (40) As previously noted, FSG only provides dark fibre from the user to the network distribution centres and does not sell services over the network, thereby providing for a passive access network.²⁴ FSG does not have any direct or indirect interest in telecommunications service providers, and the company has a strict policy of equal treatment for all service providers. FSG does not operate any electrical equipment within

²³ This refers to activated or electronic equipment, i.e. the systems or technical components necessary to operate the network, such as lit fibre, switches, routers, etc.

²⁴ Passive network access refers to access to the passive network without any electronic equipment, i.e. physical network elements such as ducts, fibre, etc.

the network and does not limit the possibilities of service providers as regards services offered or the quality of such services.

- (41) Service providers that are interested in accessing the infrastructure will be able to use the fibre-optic cable on non-discriminatory terms. Users buy the services straight from the service providers without any interaction with FSG. All users are thus free to choose any service provider they want. The service provider will request a connection to a certain home or premises with the equipment installed in the POPs. The service provider then installs its own CPE at the user's home and provides its services via the fibre-optic cable. Neither FSG nor the end-user has to buy equipment to connect to the system.
- (42) Four service providers have already set up their equipment in the POP and sell their services through the network. These are Síminn, Vodafone, Ábótinn and Emax. Both Síminn and Vodafone offer triple-play services, *i.e.* television, internet and telephone services. Emax will offer internet and television services and Ábótinn will only offer internet services. The service providers are responsible for back-up power and all other equipment related to their network connections.

4. Comments by the Icelandic authorities

- (43) The Icelandic authorities do not consider the project to involve state aid, as they take the view that the conditions set out in Article 61(1) of the EEA Agreement are not met. Furthermore, the Icelandic authorities are of the view that the financing of the project can be characterised as the funding of a public service, that the four cumulative criteria of the "Altmark test" are fulfilled, and that the measure for that reason does not constitute state aid.
- (44) The Icelandic authorities emphasise that a broadband service is in general a service of general economic interest ("SGEI").²⁵ The Icelandic authorities noted that they contacted private operators in order to establish whether any market investor was willing to invest in the infrastructure. Since no-one declared any interest in providing the service, the Icelandic authorities concluded that these areas did indeed suffer from a market failure and would not in the near future have high-speed internet connections without public intervention. Furthermore, the Municipality conducted research to determine whether the inhabitants in the area had sufficient access to broadband and found that there was overwhelming demand for broadband improvements in the area which was not being met by private operators.
- (45) It is the Icelandic authorities' view that, prior to the roll-out of fibre-optic cable, the area around Árnes and Brautarholt would at most have been considered to be traditional "grey area" for basic broadband networks according to the description in the Authority's Broadband Guidelines.²⁶ In this regard, only one service provider was offering basic broadband services via the available copper network and it was unlikely that another

²⁵ They refer, in this regard, to Commission Decision N 196/2010 *Establishment of a Sustainable Infrastructure Permitting Estonia-wide Broadband Internet Connection* (EstWin project) (OJ C 60, 25.02.2011, p. 4).

²⁶ *Black areas* are those in which there are or there will be in the near future at least two basic broadband networks of different operators and broadband services are provided under competitive conditions. *Grey areas* are areas in which one network operator is present and another network is unlikely to be developed in the near future. *White areas* are areas in which there is no broadband infrastructure and where such infrastructure is unlikely to be developed in the near future. For further clarification, see the Authority's guidelines on the rapid deployment of broadband networks, available online at: <http://www.eftasurv.int/media/state-aid-guidelines/Part-IV---Application-of-state-aid-rules-in-relation-to-rapid-deployment-of-broadband-networks.pdf>.

network would have been developed in the near future. As regards wireless internet services, the Icelandic authorities are of the view that the quality of those transmissions was poor, especially for those located far from the transmitters. Certain weather conditions also worsened the quality of the connections. Therefore, in the absence of the fibre roll-out, the households and businesses in the community would not have had sufficient connectivity. It is thus the Icelandic authorities' view that the objectives of the EU2020 Digital Agenda would not have been met,²⁷ as many of the inhabitants of the Municipality would not have had basic broadband by 2013 and none of the inhabitants were likely to have gained access to internet speeds of 30 Mbps or above before 2020.

- (46) According to the Icelandic authorities, the project will have an overall positive effect on welfare in the community. Widespread and affordable access to broadband is perceived as being of great importance because of its ability to accelerate growth and innovation in all sectors of the economy and to promote social and territorial cohesion by improving access to an essential means of communication and participation in society. Moreover, according to the Icelandic authorities, it is clear that competition in the field of telecommunications has increased greatly in the Municipality since the network roll-out, ensuring the provision of competitive and affordable services to end-users. Finally, the Icelandic authorities emphasised that there were no binding exclusivity agreements made with the residents in the area who wished to utilize the new fibre-optic network and that they were free to use whichever network they preferred.
- (47) Finally, if the Authority were to consider the measure to constitute state aid, the Icelandic authorities have expressed the view that such aid could be considered compatible with Article 61(3) of the EEA Agreement, having regard to the objectives of the measure, including the objective to increase public broadband access in assisted areas. In this regard, the Icelandic authorities have also invited the Authority to assess whether such aid should be considered to constitute the financing of a SGEI.

²⁷ See EUROPE 2020 - A strategy for smart, sustainable and inclusive growth, COM(2010) 2020, page 12.

II. ASSESSMENT

1. The presence of state aid

(48) Article 61(1) of the EEA Agreement reads as follows:

“Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.”

(49) In the following chapters the state funding of the above-mentioned project will be assessed with respect to these criteria.

1.1 State resources

(50) According to Article 61(1) of the EEA Agreement, a measure must be granted by the state or through state resources in order to constitute state aid.

(51) At the outset, the Authority notes that both local and regional authorities are considered to be equivalent to the state.²⁸ Consequently, the state for the purpose of Article 61(1) covers all bodies of the state administration, from the central government to the city level or the lowest administrative level as well as public undertakings and bodies. Furthermore, municipal resources are considered to constitute state resources within the meaning of Article 61 of the EEA Agreement.²⁹

(52) As previously noted, Landsvirkjun’s participation in the financing of the network construction was confined to the funding needed for the roll-out of a fibre-optic cable to three designated transmitters, the construction of equipment shelters for the transmitters and the construction of masts. This was one of the infrastructural improvements needed for Landsvirkjun’s planned construction and operation of the Hvammur-, Holta- and Urriðafoss hydroplants. For the purposes of this Decision, the emphasis will thus be on the Municipality’s contribution, *i.e.* the additional funding that was needed in order to roll out a network to all homes and businesses in the Municipality.

(53) In order to constitute state aid, a measure must be attributable or imputable to the state.³⁰ Public undertakings, or undertakings organised under private law as limited liability undertakings where the state is the majority shareholder and can exercise a dominant influence, as in the case of FSG, are capable of granting state aid.³¹ However, such

²⁸ See Article 2 of Commission Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings (OJ L 318 17.11.2006 p. 17), incorporated at point 1a of Annex XV to the EEA Agreement.

²⁹ See the EFTA Surveillance Authority’s Decision No 55/05/COL, *to close the formal investigation procedure provided for in Article 1(2) in part I of Protocol 3 to the Surveillance and Court Agreement with regard to the sale of 1 744 rental apartments in Oslo (Norway)*, section II.3. p. 19 with further references, OJ L 324, 23.11.2006, p. 11 and EEA Supplement No 56, 23.11.2006, p 1.

³⁰ See joined Cases 67, 68 and 70/85 *Van der Kooy BV and others v. Commission* [1988] ECR 219; Case 308/88 *Italy v. Commission* [1991] ECR I-1433, paragraph 11; Case C-305/89 *Italy v. Commission (Alfa Romeo)* [1991] ECR-1603; and Case T-385/94 *Air France v. Commission* [1996] ECR II-2109.

³¹ In Case 78/76 *Steinike & Weinlig* the Court of Justice confirmed that the state aid rules apply equally to aid granted by public or private bodies designated or established by the state to administer aid. Thus, the prohibition in Article 61(1) EEA ‘covers all aid granted by a member state or through state resources without it being necessary to make a distinction whether the aid is granted directly by the state or by public or private bodies established or operated by it to administer the aid’.

undertakings often have a degree of autonomy in relation to decision-making which means that, in cases where the remaining elements of Article 61(1) of the EEA Agreement are satisfied, it must be determined whether the public undertaking is acting on behalf of the state in relation to the measure at issue.³²

- (54) As described in paragraphs 21-23, the measure, *i.e.* the roll-out of the fibre-optic network to all homes and businesses in the Municipality, was financed by a share capital contribution of 50 million ISK from the Municipality. Furthermore, FSG took a loan of 24 million ISK to cover the remaining cost of the project. FSG is bound by a mandate set by the Municipality Council and its board members are all members of the Council. Any decision or action by FSG thus reflects the requirements and the policy of the public authorities. It therefore appears, in line with the indicators set out by the Court of Justice in the *Stardust Marine* case,³³ that the measure is imputable to the state. Hence, state resources within the meaning of Article 61(1) of the EEA Agreement are involved.

1.2 Undertaking

- (55) In order to constitute state aid within the meaning of Article 61(1) of the EEA Agreement, the measure must confer an advantage upon an undertaking. Undertakings are entities engaged in an economic activity, regardless of their legal status and the way in which they are financed.³⁴ Economic activities are activities consisting of offering goods or services on a market.³⁵ Conversely, entities that are not commercially active, in the sense that they are not offering goods and services on a given market, do not constitute undertakings.
- (56) FSG was set up in order to construct and operate a passive access network in the Municipality. Although FSG does not sell its own services over the network, it offers neutral and open network access to all interested telecommunications providers on non-discriminatory terms. The Authority considers that the provision of network access for a fixed price to third-party service providers constitutes an economic activity and that FSG thus operates as an undertaking within the meaning of Article 61(1) of the EEA Agreement.
- (57) Furthermore, the construction of the network benefits those ISPs that had not invested in broadband infrastructure in the area and can now sell their services through FSG's network. The network construction also benefits businesses in the area that now have access to a subsidised high-speed network. All of these additional beneficiaries of the measures constitute undertakings within the meaning of Article 61(1) of the EEA Agreement.

1.3 Favouring certain undertakings or the production of certain goods

- (58) In order to constitute state aid within the meaning of Article 61 of the EEA Agreement, the measure must confer an economic advantage on the recipient and be selective in nature.
- (59) Firstly, the aid measure must confer on the beneficiary undertaking advantages that relieve it of charges that are normally borne from its budget. In the present case, the financial support will enable *FSG*, a non-profit legal entity which owns and manages the network,

³² For listing of the relevant indicators of immutability, reference is made to Case C-482/99 *France v Commission (Stardust Marine)* [2002] ECR I-4397, paragraphs 55-56.

³³ *Ibid.*

³⁴ Case C-41/90 *Höfner and Elser v Macroton* [1991] ECR I-1979, paragraphs 21-23 and Case E-5/07 *Private Barnehagers Landsforbund v EFTA Surveillance Authority* [2008] Ct. Rep. 61, paragraph 78.

³⁵ Case C-222/04 *Ministero dell'Economica e delle Finanze v Cassa di Risparmio di Firenze SpA* [2006] ECR I-289, paragraph 108.

to provide wholesale broadband services on conditions not otherwise available on the market. *Third-party providers of electronic communications services* will thus be able to provide high-speed broadband services to end users utilising the new infrastructure at conditions that would not be available under normal market conditions without state support. Furthermore, the measure aims at improving the provision of existing broadband services to business and residential users. While residential users are not subject to state aid rules, *businesses in the targeted areas* will ultimately benefit from improved broadband services and coverage compared with what would have been provided on a purely commercial basis. Therefore, the measure allows a selected number of undertakings (namely, FSG, third-party providers of electronic communications services and local businesses in the targeted areas) to be relieved of part of the costs they would normally bear for the deployment of, or the access to, an NGA network. In principle, it confers a direct economic advantage on these undertakings.³⁶

- (60) Secondly, the aid measure must be selective, in that it must favour “*certain undertakings or the production of certain goods*”. State measures supporting the deployment of broadband networks are selective in nature in that they target broadband investors and third-party service providers which are active only in certain segments of the overall electronic communications services market.³⁷ The measure in question is limited to one particular region in Iceland and favours those service providers that are interested in selling their services in that area. Therefore, in the Authority’s view the measure is selective.
- (61) However, the measure does not appear to be selective with regard to the business users of the subsidised network,³⁸ since access to the subsidised infrastructure is open to all sectors of the economy.³⁹

1.4 Distortion of competition and effect on trade between Contracting Parties

- (62) The measure must be liable to distort competition and affect trade between the Contracting Parties to the EEA Agreement to be considered state aid within the meaning of Article 61(1) of the EEA Agreement.
- (63) According to settled case-law, the mere fact that a measure strengthens the position of an undertaking compared to other undertakings competing in intra-EEA trade is considered to be sufficient to conclude that the measure is likely to affect trade between Contracting Parties and to distort competition between undertakings established in other EEA States.⁴⁰
- (64) Public involvement in deploying infrastructure to provide electronic communications services alters existing market conditions. This is because a number of firms can now choose to subscribe to the services provided by those service providers using the subsidised network instead of existing, possibly more expensive, market-based solutions. Therefore, the fact that a new broadband service becomes available at a lower price than existing ones has the effect of distorting competition.⁴¹ Moreover, state support to

³⁶ See Commission Decision N 197/2010, *Establishment of a Sustainable Infrastructure Permitting Estonia-wide Broadband Internet Connection (EstWin project)* (OJ C 60, 25.2.2011, p. 4), paragraph 44.

³⁷ See paragraph 9 of the Broadband Guidelines.

³⁸ Subsidies to residential users fall outside the scope of Article 61(1) of the EEA Agreement.

³⁹ See paragraph 9 of the Authority’s Broadband guidelines.

⁴⁰ Case E-6/98 *The Government of Norway v EFTA Surveillance Authority* [1999] Ct. Rep. 76, paragraph 59; Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paragraph 11.

⁴¹ See Commission Decisions N 266/2008, *Broadband in rural areas of Bayern* (OJ C 12, 17.1.2009, p. 1), paragraph 25.

broadband can reduce profitability and crowd out investment by market players that might otherwise be willing to invest in the targeted area or in parts of it.

- (65) FSG will be active in deploying and managing a broadband network infrastructure in a market which can be entered directly or through financial involvement by participants from other EEA States. In general, the markets for electronic communications services (including the wholesale and the retail broadband markets) are open to trade and competition between operators and service providers across the EEA. Therefore, the measure could also be liable to affect trade between EEA States.
- (66) Therefore, in the Authority's view, the measure distorts competition and affect trade within the EEA.⁴²

1.5 Funding of a service of general economic interest and the *Altmark* test

- (67) The Icelandic authorities take the view that the financing of the network construction should be characterised as the funding of a service of general economic interest and that the four cumulative criteria of the "*Altmark* test" are fulfilled such that the measure does not constitute state aid.
- (68) The Court of Justice's judgment in the *Altmark* case provides clarification regarding the conditions under which public service compensation does not constitute state aid, owing to the absence of any advantage.⁴³ However, for such compensation to escape qualification as state aid in a particular case, four cumulative conditions, commonly referred to as the *Altmark* criteria, must be satisfied.⁴⁴
- (69) The four conditions are as follows: (i) the beneficiary of a state-funding mechanism for an SGEI must be formally entrusted with the provision and discharge of an SGEI, the obligations of which must be clearly defined; (ii) the parameters for calculating the compensation must be established beforehand in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings; (iii) the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the SGEI, taking into account the relevant receipts and a reasonable profit for discharging those obligations; and (iv) where the beneficiary is not chosen pursuant to a public procurement procedure, the level of compensation granted must be determined on the basis of an analysis of the costs which a typically well-run undertaking would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit.
- (70) EEA States have, in general, a wide discretion concerning the identification of a service as an SGEI, while following the relevant case-law which sets out the general principles to be respected.⁴⁵ In principle, public service compensation may be granted to an undertaking entrusted with the construction and operation of a broadband network. According to paragraph 16 of the Broadband Guidelines, this may be the case where it can be demonstrated that private investors may not be in a position in the near future (a period of

⁴² See EFTA Surveillance Authority Decision No 231/11/COL and Commission Decision SA.33063 – *Italy – Trentino NGA*.

⁴³ Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, [2003] ECR I-7747.

⁴⁴ See paragraphs 87 to 93 of the judgment.

⁴⁵ See the Authority's Guidelines on the application of the state aid rules to compensation granted for the provision of services of general economic interest [not yet published], available online at: <http://www.eftasurv.int/media/state-aid-guidelines/Part-VI---Compensation-granted-for-the-provision-of-services-of-general-economic-interest.pdf>.

three years) to provide adequate broadband coverage to all citizens or users thus leaving a significant part of the population unconnected. Consequently, a publicly-funded network set up in white areas for all potential users, business or private, may be financed by way of public service compensation. However, a number of conditions have to be fulfilled, in particular those set out in paragraphs 17 to 23 of these Broadband Guidelines.

- (71) The Icelandic authorities have described the reasons why the roll-out of an NGA network in rural areas not served by private investment needs to be financed by the State in the general economic interest. After consulting stakeholders and the inhabitants of the Municipality, it was established that the area would not be served by high-speed internet infrastructure on market terms within the next three years. The Icelandic authorities emphasised why they considered it important to avoid a “*digital divide*” between urban and rural areas.
- (72) The provision of adequate broadband coverage to all citizens in areas where no other operators are providing, or will provide, such services in the near future, could well be characterised as an SGEL.⁴⁶ Indeed, the economics of broadband provision are such that the market will not always find it profitable to invest in it in all areas. Due to economics of density, broadband networks are generally more profitable to roll out where potential demand is higher and more concentrated, i.e. in densely-populated areas. Because of high fixed costs of investment, unit costs increase strongly as population density declines. As a result, broadband networks tend to profitably cover only part of the population. Remoteness, such as larger distances from existing telecommunications infrastructure, could also significantly increase the investment costs necessary to roll out adequate broadband networks. Likewise, in certain areas, it may only be profitable for a single provider to set up a network, not for two or more.
- (73) Typically, these underserved regions are rural areas with a low population density, in which commercial providers have no economic incentives to invest in electronic communications networks to provide adequate broadband services. This may lead to a “digital divide” between the areas which have access to adequate broadband services and those that have not. As a consequence, it is in the declared general economic interest that EEA States can employ public funds to enable connectivity in areas which would not otherwise be served by high-speed internet, either currently or in the near future.
- (74) The Icelandic authorities have demonstrated the necessity of their intervention. As described in Chapter 3.2.3 of Part I above, the authorities have confirmed that there was a serious lack of high-speed broadband coverage in the Municipality. Moreover, there was only one service provider providing limited internet services in the area and public consultations revealed no investment plans in this area in the near future in view of its low commercial attractiveness for private operators. In addition, it has been confirmed that the technology in use was not capable of being upgraded to a performance level which the Icelandic authorities aim at for the future⁴⁷ and which, according to the authorities, can currently only be offered by fibre-optic infrastructure in the area.

⁴⁶ As expressed by the Commission previously in the area of access to broadband services, for instance in Commission Decision N 381/04, *Pyrénées-Atlantiques*, (OJ C 162, 2.7.2005, p. 5). See also paragraph 49 of the Authority’s Guidelines on the Application of the state aid rules to compensation granted for the provision of services of general economic interest), and paragraph 22 of the Authority’s 2010 Guidelines on the Application of state aid rules in relation to rapid deployment of broadband networks, the Authority will address the relevance of these guidelines in Section II.2.1 of this decision).

⁴⁷ See for example the Parliamentary resolution on a twelve-year telecommunications strategy from 2011 to 2022, doc 593 case 172.

- (75) FSG was given a clear mandate, assigned by way of a legally-binding municipal decision and in more detail in the company's articles of association, which, according to the Authority's Guidelines on the application of the state aid rules to compensation granted for the provision of services of general economic interest, can be seen as required entrustment acts.⁴⁸ According to FSG's mandate, the broadband infrastructure to be deployed should provide universal connectivity to all users in a given area, residential and business users alike. Moreover, the provider of the network to be deployed must not be able to refuse access to the infrastructure on a discretionary and/or discriminatory basis.
- (76) Furthermore, in line with paragraphs 19-20 of the Broadband Guidelines, the Icelandic authorities have confirmed that the publicly-funded network will be available for all interested service providers which will have open, non-discriminatory access to the passive infrastructure. Such passive network access should in turn help facilitate effective competition at downstream levels of the value chain and promote the provision of competitive and affordable services to end-users. The entrustment and the aid only covers the deployment of a network and the provision of the related wholesale access services, without including retail communications services.
- (77) The Icelandic authorities have also established the parameters for calculating the compensation in advance in an objective and transparent manner. They specified that only the effective costs of constructing the network would be supported and that, once operational, the network would be self sustainable. In order to avoid creating an undue advantage, the Municipality retains the ownership of the network through FSG, their SPV company.
- (78) Finally, to fulfil the *Altmark* criteria, in principle the service compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the SGEL, taking into account the relevant receipts and a reasonable profit. Furthermore, where the beneficiary is not chosen pursuant to a public procurement procedure, the level of compensation granted must be determined on the basis of an analysis of the costs which a typical well-run undertaking would have incurred in discharging those obligations. However, the Icelandic authorities decided not to issue a public tender to identify whether private operators would be interested in financing part of the network, thereby limiting the aid intensity and aid amount to the minimum necessary to achieve the envisioned goal.⁴⁹ Also, no other mechanism is in place to assure the Authority that the service is provided at the least cost to the community and the Icelandic authorities have not shown that an analysis was conducted on the basis of the costs which a typical well-run undertaking would have incurred in discharging those obligations.
- (79) Hence, at this stage, the Authority concludes that the measure, although it constitutes funding of a service of general economic interest within the meaning of Article 59(2) of the EEA Agreement, does not fulfil all of the *Altmark* criteria.

1.6 Conclusion with regard to the presence of state aid

- (80) With reference to the above considerations the Authority concludes that the measure under assessment includes elements of state aid within the meaning of Article 61(1) of the EEA Agreement. Under the conditions referred to above, it is thus necessary to consider

⁴⁸ See paragraph 52 of the Authority's guidelines on the Application of the state aid rules to compensation granted for the provision of services of general economic interest.

⁴⁹ See for example Commission Decision N 196/2010 *Establishment of a Sustainable Infrastructure Permitting Estonia-wide Broadband Internet Connection*, paragraph 61.

whether the measure can be found to be compatible with the functioning of the EEA Agreement.

2. Procedural requirements

- (81) Pursuant to Article 1(3) of Part I of Protocol 3, “*the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid (...). The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision*”.
- (82) The Icelandic authorities did not notify the aid measure to the Authority. Moreover, the Icelandic authorities have, by financing the construction of the broadband network, put the measure into effect before the Authority adopted a final decision. The Authority therefore concludes that the Icelandic authorities, have failed to respect their obligations pursuant to Article 1(3) of Part I of Protocol 3. The granting of any aid involved might therefore be unlawful.

3. Compatibility assessment

3.1 Introduction

- (83) Support measures caught by Article 61(1) of the EEA Agreement are generally incompatible with the functioning of the EEA Agreement, unless they qualify for a derogation under Article 61(2) or (3) or Article 59(2) of the EEA Agreement and are necessary, proportional and do not cause undue distortion of competition. The Icelandic authorities argue that any aid involved in the project would be compatible with Article 61(3) of the EEA Agreement.
- (84) The Authority will examine, in the following section, –the compatibility of the measure in question with Article 61(3)(c) of the EEA Agreement. The Authority’s examination will be conducted, in particular, in light of the recently published (2013) Broadband Guidelines⁵⁰ which contain a detailed interpretation of Article 61(3)(c) of the EEA Agreement in this sector, as well as in line with general decisional practice in this area.

3.2 Distinction between white, grey and black areas for NGA networks

- (85) According to the Broadband Guidelines, in order to carry out a compatibility assessment of public financing of NGA projects, the region in which the new broadband network will be deployed needs to be defined as a white, grey or black area.⁵¹
- (86) “*White NGA area*” refers to an area where NGA networks do not at present exist and where they are not likely to be built and be fully operational in the near future by private investors, regardless of whether basic broadband infrastructure provided over existing copper network is already in place in that region or not. The term “*in the near future*” corresponds in that regard to a period of three years. This period appears to correspond to an average period needed for the deployment of an NGA network covering a town or a city. In this regard, an operator should be able to demonstrate that within the coming three-year period it would carry out the necessary infrastructure investments in order to cover a substantial part of the territory and the population concerned.
- (87) “*Grey NGA area*” refers to an area where only one NGA network is in place or will be deployed in the coming three years and there are no plans by any other operator to deploy

⁵⁰ See footnote 6 above.

⁵¹ See paragraph 69 of the Broadband Guidelines.

an NGA network in that time period. In assessing whether other network investors could deploy additional NGA networks in a given area, account should be taken of any existing regulatory or legislative measures that may have lowered barriers for such network deployments (access to ducts, sharing of infrastructure etc.).

- (88) “*Black NGA area*” refers to an area where more than one NGA network exists or will be deployed in the coming three years (cf. paragraph 68 of the Broadband Guidelines).
- (89) According to the Icelandic authorities, the area of the project was, prior to the construction of the network, not covered by any NGA network. As regards traditional wired broadband networks, the Icelandic authorities have acknowledged that parts of the buildings covered by the new NGA network already had access to basic broadband infrastructure, mainly based on Míla’s copper network (*i.e.* that they could constitute traditional grey areas). Furthermore, the basic broadband providers only offered limited services of low-speed internet connections. Finally, with regard to the available wireless internet services, the Icelandic authorities state that wireless transmissions were poor, especially for users located far from the transmitters and the weather also worsened the quality of these connections.
- (90) Thus, in light of the above, the Authority considers the areas covered by the project as “*white NGA areas*” for the purposes of applying the Broadband Guidelines.

3.3 The balancing test and the Broadband Guidelines/decisional practice

- (91) In assessing whether an aid measure can be found to be compatible with the functioning of the EEA Agreement, the Authority balances the positive impact of the aid measure in reaching an objective of common interest against its potentially negative side-effects, such as distortions of trade and competition.
- (92) In applying this balancing test, the Authority will assess the following questions:⁵²
- a) 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?
 - b) Is the aid well-designed to deliver the objective of common interest? In particular:
 - (i) Is state aid an appropriate policy instrument, *i.e.* are there other, better-placed instruments?
 - (ii) Is there an incentive effect, *i.e.* does the aid change the behaviour of undertakings?
 - (iii) Is the aid measure proportional, *i.e.* could the same change in behaviour be obtained with less aid?
 - c) Are the distortions of competition and the effect on trade limited, so that the overall balance is positive?

3.3.1 Objective of common interest

- (93) Broadband connectivity is a key component for the development, adoption and use of information and communication technologies in the economy and in society. In its Europe

⁵² See for example Commission Decisions C 35/2005, *Broadband development Appingedam* (OJ L 86, 27.3.2007, p. 1), and N 14/2008, *Broadband in Scotland - Extending broadband reach..*

2020 Strategy of 3 March 2010, "A Digital Agenda for Europe", the European Commission stated that it has the "aim to deliver sustainable economic and social benefits from a Digital Single Market based on fast and ultra fast internet and interoperable applications, with broadband access for all by 2013, access for all to much higher internet speeds (30 Mbps or above) by 2020, and 50% or more of European households subscribing to internet connections above 100 Mbps."⁵³

- (94) According to the Icelandic authorities, the availability of high-speed broadband infrastructure is a key factor for the local communities in attracting businesses, improving local living conditions, as well as accelerating growth and innovation in all sectors of the local economy. The Icelandic authorities expect that the construction of the network will increase social cohesion and contribute to economic growth. Furthermore, the Icelandic authorities noted that general access to high-speed broadband services concerns a general and basic need and represents a specific general interest to be distinguished from other economic activities. By constructing and operating the network through an SPV, the Icelandic authorities intend to allow the use of the public network to bridge the traditional digital divide (i.e. as regards basic broadband) wherever necessary. This concerns specifically traditional "white areas" where no broadband infrastructure is present or problematic "grey areas", in which the presence of one infrastructure does not exclude the existence of a market failure or cohesion problem.
- (95) The Authority considers support for broadband network deployment in rural and underserved white areas as promoting territorial social and economic cohesion and addressing market failures.⁵⁴ Moreover, the roll-out of a broadband network contributes to reducing a potential "digital divide" that can set apart areas or regions within a country where affordable and competitive broadband services are on offer and areas where such services are not.⁵⁵ It is therefore the Authority's view that the aid pursues genuine cohesion and economic development objectives, which are considered to be well-defined objectives of common interest.

3.3.2 Design of the measure and the need to limit distortion of competition

3.3.2.1 Is aid the appropriate instrument?

- (96) The Authority has not received information on whether the Icelandic authorities considered any alternatives to public financing of the broadband network in order to address the market failure. However, the Authority, as well as the European Commission, has previously examined the use of grants or tax incentives to end users, as well as the possibility of using *ex ante* regulation in similar situations.⁵⁶ These measures have been found unlikely to lead to sufficient investments for the provision of broadband services to underserved areas.
- (97) As previously noted, there were only limited services of low-speed internet connections available a portion of the Municipality and the excising operator did not have any plans to upgrade its broadband infrastructure. Moreover, the Icelandic authorities noted that the large internet service providers in Iceland had not shown any interest in improving the internet connections in the area or to invest in NGA infrastructure in the Municipality in

⁵³ EUROPE 2020 – A strategy for smart, sustainable and inclusive growth, COM(2010) 2020, page 12.

⁵⁴ See paragraphs 62 of the Broadband Guidelines.

⁵⁵ See for example EFTA Surveillance Authority Decision No 231/11/COL, Section 3.2.1.2.

⁵⁶ See for example the EFTA Surveillance Authority Decision No 231/11/COL and Commission Decision N 14/2008, *Broadband in Scotland - Extending broadband reach*, paragraphs 54-55.

the near future.⁵⁷ Hence, in situations such as the case at hand, where it has been confirmed that there is a significant under-development of broadband infrastructure and services in a given region, there seems to be no alternative to granting public funding to overcome the lack of broadband connectivity.

- (98) It is therefore the Authority's view that public funding for the provision of broadband services is an appropriate instrument to achieve the set objectives.

3.3.2.2 Does the aid have an incentive effect?

- (99) The public consultation conducted by the Icelandic authorities showed that it was unlikely that a broadband network covering the un-serviced buildings would be provided by the market in the near future. Furthermore, according to the authorities, there was only very limited competition and a limited offering of lower speed services in the area prior to the construction of the network. By financing the roll-out of the high-speed network, and offering passive, neutral, and open access to all interested operators across all sectors, various service providers, that would not have invested in high-speed broadband infrastructure in the Municipality, have started offering services based on this infrastructure in the area. On the basis of the above, the Authority concludes that the aid had an incentive effect.

3.3.2.3 Proportionality of the aid and limitation of distortion of competition and effect on trade

Detailed mapping and coverage analysis and public consultation

- (100) According to the Icelandic authorities, the Municipality Council carried out a detailed mapping and coverage analysis prior to the construction of the network. Hence, the competitive conditions and structure prevailing in the given area were analysed and stakeholders affected by the relevant measure were consulted. Furthermore, the Council contacted service providers to see whether they had plans to either upgrade their infrastructure or invest in new infrastructure in the near future and found that there were no such plans. Against this background, the Authority's view is that the mapping and coverage analysis contributed to minimising potential distortions of competition.

Competitive selection process / Most economically advantageous offer

- (101) As noted in paragraph 74(c) of the Broadband Guidelines (footnote 91), a public authority may decide to deploy and manage the network directly (or through a fully-owned entity).⁵⁸ In such cases, therefore, the issue of competitive selection process for the network deployment and operation does not arise. However, with a view to safeguarding competition in such cases, it is specified that the publicly-owned network provider shall: (i) limit its activity on the pre-defined target areas and not expand to other commercially attractive regions; (ii) limit its activity to maintaining the passive infrastructure and to granting access to it, but not engage in competition on the retail level with commercial providers; and (iii) have an accounting separation between the funds used for the operation of the networks and the other funds at the disposal of the public authority.
- (102) In relation to points (i) and (ii) above, FSG's mandate, as already discussed in section 3.2.2 above, was clearly defined as the construction and operation of a fibre-optic network

⁵⁷ The Icelandic authorities contacted private operators in order to establish whether any market investor was willing to invest in the infrastructure. After finding that there was no interest in providing the service, the Icelandic authorities concluded that these areas did indeed suffer from a market failure and would not in the near future have high-speed internet connections without public intervention.

⁵⁸ Such as in the Commission Decisions in Case N 330/2010 - *France Programme National Très Haut Débit* and SA.33807 (2011/N) - *Italy, National Broadband Plan*.

for the specific Municipality in question. Furthermore, the Icelandic authorities have confirmed that FSG's activity will be limited to maintaining the passive infrastructure and granting access to it to third-party service providers. It has also been clarified that FSG is not vertically integrated and will therefore not itself be active on the retail level. As regards point (iii) above, the Icelandic authorities have also confirmed that only the effective costs of constructing the network will be supported and that, once operational, the network would be self sustainable. To avoid creating an undue advantage, the Municipality also retains the ownership of the network through FSG, as their SPV company.

- (103) The Municipality did however carry out an open and competitive tender process for two aspects of the network deployment process. The first tender procedure was to select a provider to lay down approximately 145 km of ducts and the second tender procedure was to select a provider to blow the fibre-optic cable into the ducts. The Municipality received bids from several operators concerning both projects and, after evaluating the bids with regard to the tender criteria, selected the most favourable valid bids. In both instances the bids chosen were considerably lower than what the Municipality had predicted in its own cost analysis. Therefore, with regard to the network deployment process itself, the criteria of a competitive selection process and choosing the most economically advantageous offer were fulfilled.

Technological neutrality

- (104) Given the specific characteristics of the region, the Municipality decided to base the subsidised NGA network on fibre-optic technology. While the Authority has not received specific details of the available technological options assessed preceding that decision, the use of fibre-optic technology is nonetheless in line with the definition of NGA networks in paragraph 54 of the Broadband Guidelines. This paragraph specifically identifies fibre-based technology as providing the recognised features of high-speed, reliability and ability to support a variety of enhanced services.
- (105) According to the Icelandic authorities, FSG only provides a passive access network to third-party service providers and the network is open for all technical solutions employed by such providers and hence technology neutral. The measure will therefore not favour any particular technology used in conjunction with the passive NGA network, leaving it to commercial providers to come up with the most appropriate technological solutions to provide retail services to end users. Furthermore, FSG does not limit the service providers' possibilities as regards services offered or the quality of such services.⁵⁹

Use of existing infrastructure

- (106) According to the Icelandic authorities, the Municipality was characterised by a lack of existing broadband infrastructure. Only about 10% of the Municipality inhabitants could use the ADSL connections based on the existing copper infrastructure and the existing wireless connections were also perceived as being of poor quality. The Icelandic authorities noted that the incumbent supplier of copper-based infrastructure in the region was frequently asked to improve internet connections, but the company showed no interest in developing the network in the area.
- (107) The Icelandic authorities were therefore of the view that, before the fibre-optic network was rolled out, broadband possibilities in the Municipality were limited, out-dated and

⁵⁹ See, for example, Commission Decision C(2006)436 final, Case N 284/2005 – *Ireland Regional Broadband Programme: Metropolitan Area Networks* (“MANs”), phases II and III, Brussels, 08.III.2006.

inadequate and that it was therefore necessary to lay down new fibre-optic infrastructure so as to give the inhabitants access to higher internet speeds and greater service choice. Against this background, the use of existing infrastructure does not appear to have played an important role in the deployment of the subsidised NGA network.

Wholesale access

- (108) Mandating effective third-party wholesale access is a necessary component of any state measure funding the construction of a new broadband infrastructure. In particular, wholesale access enables third-party service providers to compete actively on the market, thereby strengthening choice and competition in the areas concerned by the measure, while, at the same time, avoiding the creation of regional service monopolies.⁶⁰ Furthermore, granting effective wholesale access to competitors minimises the distortions of competition that follow from any state aid measure.
- (109) The importance of granting effective third-party wholesale access to subsidised networks has also been emphasised by both the Authority and European Commission in numerous decisions.⁶¹
- (110) The Broadband Guidelines emphasise that wholesale access obligations imposed on a subsidised network should be aligned with the portfolio of access obligations laid down under the sectoral regulation rules. However, in principle, subsidised companies should provide a wider range of wholesale access products than those mandated by national regulatory authorities (“NRAs”) under sectoral regulation since the aid beneficiary is using, not just its own resources, but also taxpayers' money to deploy its own infrastructure. Such wholesale access should be granted as early as possible before starting network operation.⁶² Furthermore, the Broadband Guidelines note that effective wholesale access to the subsidised infrastructure should be offered for at least a period of 7 years. However, whenever the state aid measure covers the funding of new passive infrastructure elements such as ducts or poles, access to those should also be granted and be unlimited in time.
- (111) As previously noted, the network was designed to be passive, neutral, open and available to all interested operators across all sectors with all possible forms of network access. This open access model has not been limited in time by the relevant authorities. In addition, the network operator is not active on the retail level, i.e. it is not vertically integrated, thus reducing its incentives to impede supply and/or discriminate between different wholesale access seekers. The Icelandic authorities have stressed that FSG will only own and run dark fibre. The company will not run active equipment or CPE and will not offer any kind of telecommunications services to end users. Those service providers that are interested will therefore be able to use the fibre-optic infrastructure on non-discriminatory terms, since, according to the Icelandic authorities, FSG has a strict policy of equal treatment for all service providers. The service provider can request a cable connection to a certain

⁶⁰ Paragraph 74(g) of the Broadband Guidelines.

⁶¹ See the EFTA Surveillance Authority's Decision No 302/13/COL, *to initiate the formal investigation procedure into potential state aid granted to Síminn for the roll-out of broadband services in rural areas in Iceland*, section II.2. paragraphs 91-104 (not yet published) and Commission Decisions C 53/2006 *Investment by the city of Amsterdam in a fibre-to-the home (FtH) network* (OJ L 247, 16.9.2008, p. 27), paragraph 96, and N 14/2008 *United Kingdom, Broadband in Scotland - Extending Broadband Reach*, paragraph 57(c), and N 475/2007– *Ireland, National Broadband Scheme ("NBS")*, paragraph 45(e).

⁶² Paragraph (74)(g) of the Broadband Guidelines. That paragraph also notes that effective wholesale access to the subsidised infrastructure should be offered for at least a period of 7 years. However, whenever the State aid measure covers the funding of new passive infrastructure elements such as ducts or poles, access to those should also be granted and be unlimited in time.

home with the equipment installed in the POPs. The service provider would then install its own CPE at the user's home and provides its services through the fibre-optic cable.⁶³

(112) Furthermore, the inhabitants and the businesses in the Municipality were informed prior to the opening up of the network that it would be passive, neutral and open to all service providers interested in selling their services through the network and they could therefore potentially choose between various service providers. It is also important to note that the network architecture was set up so to allow users to choose to buy different services from two service providers, e.g. internet services from one provider and television services from another, thereby further enhancing competition on the relevant market. FSG is not vertically integrated and thus lacks discriminatory incentives.

Wholesale access pricing

(113) According to paragraph 74(h) of the Broadband Guidelines, wholesale access prices should be based on the pricing principles set by the NRA and on benchmarks and should take into account the aid received by the network operator. However, the Icelandic PTA did not include broadband services delivered over fibre-based infrastructures in its decision on the wholesale broadband market, *i.e.* market 5 in the Authority's Recommendation on Relevant Markets.⁶⁴ Fibre is also excluded from the market for wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location (market 4). Therefore, the Icelandic PTA has to date not imposed wholesale access pricing obligations with regard to fibre networks.

(114) Furthermore, with regard to the particulars of this case, it is useful to recall FSG's specific role as a wholesale-only provider of passive NGA infrastructure, its lack of vertical integration into downstream wholesale and retail markets, and its clear mandate to provide open and non-discriminatory access as well as to be financially self-sufficient. In this respect, the project structure is well-positioned to produce market-reflective wholesale access prices. This is also reflected by the fact that to date there has been a material uptake of the wholesale access offerings over the newly constructed network.⁶⁵

Monitoring and claw-back mechanism

(115) According to the Broadband Guidelines,⁶⁶ the claw-back mechanism is not necessary in case of publicly-owned, wholesale-only infrastructures which are managed by the public authority with the sole purpose to grant fair and non-discriminatory access to all operators, provided the conditions referred to in paragraph (101) above are met. As discussed in paragraph (102) above, the Authority is of the view that the current project meets this relevant standard and thus no further analysis is necessary in this respect.

⁶³ With regard to the availability of active access products, it should be noted that Síminn is subject to certain obligations on a national level to provide such access pursuant to the Icelandic PTA's Decision No 8/2008 on Market 12, the decision is available online at: http://pfs.is/upload/files/%c3%81kv%c3%b6r%c3% b0un%20nr %2082008_M%2012.pdf.

⁶⁴ See the EFTA Surveillance Authority Recommendation of 5.11.2008 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with the Framework Directive, OJ C 156, 9.7.2009, p.18.

⁶⁵ As noted in paragraph 42, four service providers, Síminn, Vodafone, Ábótinn and Emax have already set up their equipment in the POP and started selling their services through the network.

⁶⁶ Footnote 109 of the Broadband Guidelines.

Transparency

- (116) According to paragraph 74(j) of the Broadband Guidelines, EFTA States are to publish certain key information regarding the state aid measure⁶⁷ on a central website. The aid beneficiary is also obliged to provide comprehensive and non-discriminatory access to information on infrastructure deployed under the state aid measure.
- (117) As previously noted, the Municipality has ensured that all of its decisions relating to the founding of FSG and its mandate and operations are publicly available on the Municipality's home page.⁶⁸ FSG should also provide, upon request, non-discriminatory access to information on the infrastructure that was deployed under the state aid measure. Furthermore, the tender procedure was open and transparent and the tender description, as well as information on the opening of tenders, was published online at the Verkfræðistofa Suðurlands home page.⁶⁹ Therefore the transparency requirements, as set out in the Broadband Guidelines, were fulfilled with regard to the project.

Reporting

- (118) According to paragraph 74(k) of the Broadband Guidelines, the aid-granting authorities should report key information on the aid project every two years to the Authority (starting from the date when the network is put into use).⁷⁰ While the aid measure in question was not formally notified to the Authority, the Icelandic authorities have now provided the relevant or key information in response to the Authority's information requests. This information should now be submitted bi-annually to the Authority as part of Iceland's annual reporting obligations for state aid measures.

3.4 Conclusion with regard to the balancing test and the compatibility of the measure

- (119) After having assessed the measure under the relevant criteria of the balancing test, the Authority concludes that, on balance, the notified measure will contribute towards offsetting a geographic and commercial disadvantage in this rural area which would not otherwise be addressed via market-based solutions in the near future. The measure is also aimed at promoting the competitive supply of innovative and high-quality NGA broadband services across the Municipality.
- (120) Furthermore, the design of the project and the possibilities for effective wholesale access (including *inter alia* the open and non-discriminatory network design and the wholesale-only business model of the aid beneficiary, together with its clear mandate to grant fair and non-discriminatory access to all service providers) ensure that any distortion of competition caused by the state intervention is kept to the minimum possible.
- (121) Therefore, on the basis of the above considerations, the result of the overall balancing test is positive and the financing of the network is thus be compatible with the state aid rules of the EEA Agreement.

⁶⁷ Including at least the following information: the full text of the approved aid scheme and its implementing provisions, name of the aid beneficiary, aid amount, aid intensity and used technology.

⁶⁸ The minutes of the Municipality Council meetings, where the decision of the Council are adopted, are available online at: http://www.skeidgnup.is/sidustu_fundargerdir/.

⁶⁹ <http://www.verksud.is/>.

⁷⁰ Such information should include, in addition to the public information referred to in paragraph 74(j) of the Broadband Guidelines, the date when the network is put into use, the wholesale access products, the number of access seekers and service providers on the network, the number of houses passed, take-up rates.

4. Conclusion

- (122) Based on the above considerations, the Authority concludes the municipal financing of the rapid deployment of an NGA broadband network in the municipality of Skeiða- and Gnúpverjahreppur constitutes state aid that is compatible with the functioning of the EEA Agreement within the meaning of Article 61(3)(c) of the EEA Agreement.
- (123) The Icelandic authorities are also reminded that all plans to modify the individual aid to be granted, including any increase in the grants by the Municipality by more than 20%, should be notified to the Authority.

HAS ADOPTED THIS DECISION:

Article 1

The EFTA Surveillance Authority concludes that the grants made to facilitate the rapid deployment of a Next Generation Access network in the municipality of Skeiða- and Gnúpverjahreppur constitute an aid measure compatible with the EEA Agreement. Accordingly, the Authority raises no objections on the basis of Article 61(3)(c) of the EEA Agreement.

Article 2

This Decision is addressed to Iceland.

Article 3

Only the English language version of this Decision is authentic.

Decision made in Brussels, on 13 November 2013.

For the EFTA Surveillance Authority

Oda Helen Sletnes
President

Sverrir Haukur Gunnlaugsson
College Member