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Do not adjust your set

STATE AID RULES AND PUBLIC SERVICE BROADCASTING

Late last year, the European Commission finally published its long-awaited guidelines on the application of state aid rules to public service broadcasting.[1] *These provide a framework for interpreting the relevant legislation in the context of broadcasting and they clarify the specific role of the Commission. However, the guidelines give few details of how the framework provided should be applied in practice.*

Our viewing choice is expanding rapidly. Twenty years ago in the UK we had a choice of three television channels; BBC1, BBC2 and ITV. Now we have five such free-to-air terrestrial channels and in addition over one hundred and twenty channels that can be viewed via satellite, cable and digital terrestrial technology, including four new digital channels from the BBC.[2] A similar pattern can be observed across Europe.

In this new world, public service broadcasters and commercial broadcasters operate alongside one another, competing for both programme content and audiences. However, many broadcasters feel that they are not competing on a level playing field.

For example, there are terrestrial broadcasters, including public service broadcasters, who feel unable to compete effectively with pay-TV operators for the acquisition of popular content (live football, say). Meanwhile, there are commercial broadcasters who believe the funding of certain services offered by public service broadcasters amounts to "state aid", which distorts competition to an unacceptable degree.

To date, the European Commission has dealt with a number of state aid cases involving public service broadcasters. All have resulted in the Commission finding that there was no breach of the EU's state aid rules. The new guidelines are intended to clarify the way in which such decisions will be taken in the future.

THREE TESTS FOR COMPATIBLE STATE AID

State aid rules, defined by Article 87 of the EC Treaty, declare that any aid granted by a Member State that distorts or threatens to distort competition by favouring certain undertakings shall be incompatible with the common market. The rules apply to all types of aid, financial or otherwise, and to any activity. However, the rules do allow for aid to certain activities in certain circumstances to be compatible with the common market.

The question addressed by the Commission's new guidelines is whether and in what circumstances state aid to public service broadcasters is compatible with the common market. The guidelines give three tests of compatibility.

- **Definition:** the service in question must be deemed a service of 'general economic interest' and clearly defined as such by the Member State.

- **Entrustment:** the undertaking in question must be explicitly entrusted by the Member State with the provision of that service.

- **Proportionality:** it must be established that the application of the competition rules of the EC Treaty would obstruct the performance of the particular tasks assigned to the undertaking and the exemption from such rules would not affect the development of trade to an extent that would be contrary to the interests of the Community.

The Commission states that both the first and second points are essentially matters for individual Member States. The focus of the guidelines is therefore on the third condition – the proportionality test – that is to be applied by the Commission. What might this test mean in practice?

NO EXCESS

The first part of the proportionality test requires that, once the public service remit has been defined, the state aid must not exceed the net costs of providing the public service, taking into account any direct or indirect revenues derived from it. The guidelines suggest that the application of this test is largely a matter of ensuring that appropriate accounting systems are in place and that costs incurred and revenues generated are properly identified.

The guidelines acknowledge that identifying the costs of the public service remit can be complicated when the public service broadcaster also undertakes commercial activities, and there are common or joint costs of production arising from the shared use of inputs. The Commission proposes that all truly joint costs be allocated to the public service remit, even if there are commercial activities that benefit from the activities generating these costs. As a result, the costs of the public service remit will be equal to the total costs incurred by the public service broadcaster less any costs specifically attributable to the commercial activities.

Arbitrary apportionment decisions should thereby be avoided, but not all the intellectual difficulties. For such an approach involves assessing the level of costs that would be incurred in a different (hypothetical) state of the world; that is, what would costs be if all commercial activities were discontinued and only public service activities were undertaken? Consider the use made of studios. It would be incorrect to allocate the total costs of studio provision to the public service activities if discontinuing commercial activities would lead to only a proportion of existing studio capacity being required for public service activities.

The allocation of common costs will depend to a large extent on the existence of economies of scale and scope in the joint provision of public and commercial services. The Commission's guidelines may therefore require public service broadcasters to develop and manage their accounting systems in a manner that differs markedly from current practice.

NO LIMITS

The first part of the proportionality test potentially raises a second difficult question – what level of cost is actually necessary to deliver the public service remit? Should public service broadcasters be allowed to invest more in programming than would be viable for commercial broadcasters? If so, how much more and in what circumstances? This issue is not addressed in the Commission's guidelines.

Yet it arose during the Commission's investigation of the launch of BBC News 24. The complainant, BSkyB, argued that the funding received by BBC News 24 was not proportionate to its costs, given that the amount invested by the BBC was "far higher than the costs of competing commercial services, including BSkyB's SkyNews channel". The Commission noted that higher costs were due to the more extensive news-gathering network of the BBC, with 47 offices worldwide compared to SkyNews's 8 offices and CNN's 34. However, the Commission did not comment on whether the level of costs would be necessary to deliver the public service remit. Its focus instead was on the potential distortions to trade that might result.

IDENTIFYING DISTORTIONS

The guidelines focus on identifying those distortions that arise from conduct that is not necessary in order to deliver the public service remit. The Commission describes how such a distortion might arise in the case of a public service broadcaster who is allowed to sell advertising. It might be feasible for such a broadcaster to price its advertising space below market levels, in so far as the lower revenues achieved are covered by state aid. This could significantly affect the revenues of competing commercial broadcasters, but would not be necessary to deliver the public service remit.

But distortions may also occur as a result of conduct needed to perform the public service remit. For example, BSkyB claimed that, following the launch of BBC News 24, several cable operators discontinued SkyNews and, to remain in the market, BSkyB had to cut subscription fees charged to cable distributors. BSkyB claimed that this significantly reduced SkyNews's penetration in cable.

Furthermore, distortions could, in principle, result from the mere existence of a publicly-funded channel; due, for example, to the attraction of viewers who might otherwise switch to commercial channels.

The new guidelines provide scant details as to how such potential distortions to competition should be assessed. We suggest that a first useful distinction can be made between direct and indirect effects.

Direct distortions could result from competition between public service broadcasters and commercial operators for:

- the acquisition of programme rights and talents;
- the sale of programme rights;
- the sale of advertising.

Indirect effects might occur as public service broadcasters attract viewers from commercial channels, with implications for their commercial revenues. We illustrate some of the issues that might need to be taken into account in practice, but which are not addressed in the guidelines. We do this by considering the launch by a public service broadcaster of a new channel (without advertising) as an example. The primary effect of such a channel on rivals will be indirect, through the acquisition of viewers and possibly subscribers.

AN EXAMPLE: A NEW PUBLIC SERVICE CHANNEL

The first task for the Commission would be to determine the extent to which the public service broadcaster might gain viewers from commercial broadcasters, rather than growing the overall number of viewers or viewing hours. Expansion of the market will be more likely if the programme content of the public service channel differs in terms of genre or quality from commercial channels, or if the new channel is made available on platforms where it has the potential to increase take-up by viewers (such as new digital platforms).

To the extent that there is an identifiable reduction in audience numbers or share for commercial channels, the second consideration will be the extent to which there might be a knock-on impact on commercial revenues. But the relationship between viewers and revenues is not straightforward.

First there will be a potential indirect effect on subscription revenues. This could work either way. A new channel might increase household take-up of particular platforms, leading to an increase in revenues overall for commercial broadcasters. Moreover, it might change the bargaining power of commercial channels by making it more (or less) important that platforms carry particular channels, and, at the extreme, it might occupy limited platform-carrying capacity and thereby squeeze out other channels.

The impact on advertising revenues is equally complex, and depends on the price elasticity of demand for advertising. A loss of viewers for commercial channels means that fewer people can be reached by a single commercial. Whether advertisers then end up spending more is a question that requires further analysis. If companies scale back television advertising, because it is now less attractive, then there will be a reduction in revenues for commercial channels. On the other hand, companies may have a set number of viewers they want to reach.

The third consideration for the Commission will be the implications for competition. As indicated in the Commission's decisions to date, a fall in revenues for commercial channels does not necessarily imply a detriment to competition or customers. It is necessary to assess the potential detriment with respect to the possibility of market foreclosure. While such analysis can be controversial, there is nevertheless a set of standard principles to apply. These include identifying the impact of the loss of revenues on competitor viability, and an assessment of the implications on the number of players in the market and on the likelihood of new entry.

CONCLUSION

The Commission's new guidelines are helpful both in clarifying the framework for the application of EU state aid rules to broadcasting, and in confirming the Commission's role. However, they raise several difficult implementation issues – in particular the assessment of potential distortions to trade – on which limited detailed guidance is provided. In addition, a final conceptual question remains: what level of distortion is acceptable? Is there an absolute threshold, or is this a relative question, which will be answered taking into account the benefits of a service of general economic interest? For public services that find themselves under state aid investigation, these two approaches could have very different implications.

SOURCE	1. *"Communication from the Commission on the application of State Aid rules to public service broadcasting", Official Journal 2001/C 320/04* 2. *Frontier provided advice to the BBC on the implications of its new services for competition in digital broadcasting.*
CONTACT	**Zoltan Biro** zoltan.biro@frontier-economics.com Frontier Economics, 150 Holborn, London, EC1N 2NS UK
frontier economics	BOSTON | LONDON | MELBOURNE www.frontier-economics.com