

Alþingi
Erindi nr. P 132/1442
komudagur 23.3.2006

Case handler: Espen Bakken
Tel: (+32)(0)2 286 1818
e-mail: eba@eftasurv.int

Brussels, 30 January 2006
Case No: 48094
Event No: 358899

AUTHORITY

Dear Sir,

Subject : State aid - Financing of Ríkisútvarpið (RUV), the public service broadcaster

1. Introduction

Reference is made to the meeting in Brussels on 17 January 2006 between the Icelandic authorities and the Competition and State Aid Directorate (hereinafter the "CSA") regarding the state financing of RUV, the Icelandic public service broadcaster. Further reference is made to previous correspondence, in particular the letter dated 3 June 2005 according to Article 17(2) in Part II of Protocol 3 to the Agreement between the EFTA State on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter the "Article 17(2) letter"). The new draft legislation of the Icelandic National Broadcasting Service (Ríkisútvarpið hf) (hereinafter "the draft National Broadcasting Service Act") was submitted to the CSA by e-mail dated 12 January 2006.

According to the CSA's preliminary findings the current financing of RUV constitutes an 'existing' aid measure, for which amendments to the future might be suggested by the EFTA Surveillance Authority (hereinafter the "Authority"). Therefore, the meeting on 17 January 2006 dealt with future amendments of the Icelandic public service broadcasting system in order to comply with the EEA state aid provisions, and in particular Chapter 24 C of the State Aid Guidelines¹ (hereinafter the "Broadcasting Guidelines"). Proposals to this effect are laid down in the draft National Broadcasting Service Act, which was the main discussion point of the meeting.

The CSA appreciates the cooperation and initiatives undertaken by the Icelandic authorities to limit the compensation granted to RUV to the cost of discharging the public service broadcasting obligation. Based on the latest legislative developments on the draft National Broadcasting Service Act, the CSA sees a need for further clarifications on the issues mention below in order assess the state financing of RUV under Articles 61(1) and 59(2) of the EEA Agreement.

¹ An updated version of the State Aid Guidelines can be found on the EFTA Surveillance Authority webpage <http://www.eftasurv.int/fieldsOfWork/fieldStateAid/guidelines>.

Icelandic Mission to the European Union
Rond-Point Schuman, 11
1040 Brussels

On the topics mentioned below the CSA will make references to pages 32 and 33 of the Article 17 (2) letter in order to provide an overview on which of the points mentioned in that letter has been dealt with, or still require further explanations and/or amendments.

By reporting on the new developments, the Icelandic authorities gave the requested update as requested in point 9 on page 33 of the CSA's Article 17 (2) letter.

2. State guarantee and tax exemption

As previously explained by the Icelandic authorities, Article 2 of the National Broadcasting Service Act (i.e the unlimited liability) along with Article 5 of the Insolvency Act (i.e the exemption from bankruptcy proceedings) provide for an implicit guarantee toward creditors for the fulfillment of RUV's obligations.

Further, according to Article 4(1) of the Income and Net worth Tax Act, state enterprises operated by the Treasury and for which the Treasury bears unlimited liability (i.e. RUV) benefit from a tax exemption.

Based on information presented in the meeting, the CSA understands that the reorganisation of RUV from a state enterprise into a limited liability company will imply that the guarantee provided for in Article 2 of the National Broadcasting Act in combination with Article 5 of the Insolvency Act will be terminated. Further it will imply that as owner of a limited liability company, the Icelandic State will only be liable for its share capital in the company. Additional financial assistance to RUV needs to be carried out in line with the private market investor principle.

Regarding the tax exemption provided for in Article 4(1) of the Income and Net worth Tax Act, the CSA understands that RUV will fall outside the scope of the Act in that the tax exemption is granted to state enterprises for which the Treasury bears unlimited liability. Hence, as a limited liability company RUV will in the future be liable to ordinary company taxation.

The Icelandic authorities are kindly requested to verify the above understanding of the CSA. If correct, it would dispel CSA's concerns with regard to state guarantee for the future. Point 7 on page 32 of the Article 17 (2) letter and point 6 and 8 of the information request on page 33 would then be considered to be dealt with. No further information on the scope of the state guarantee or the correct calculation of the market premium would then be necessary, if all direct and indirect state guarantees are repealed.

3. Article 59(2) of the EEA Agreement

The state financing of RUV might be compatible under Article 59(2) of the EEA Agreement. Article 59(2) of the EEA Agreement reads;

"Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Agreement, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the

particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Contracting Parties”.

Section 24C.6 (1) of the Broadcasting Guidelines specifies further how the CSA will assess aid in the broadcasting sector in relation to Article 59(2) of the EEA Agreement:

- the broadcasting service must be a service of general economic interest, clearly defined as such by the EFTA State (*definition*);
- the undertaking must be explicitly entrusted by the authorities with the provision of the broadcasting service (*entrustment*);
- the application of the competition rules of the EEA Agreement must obstruct the performance of the tasks assigned to the undertaking and the exemption from such rules must not affect the development of trade to an extent that would be contrary to the interests of the EEA Agreement (*proportionality test*).

3.1 Definition

The following considerations deal with point 1 on page 32 and point 1 on page 33 of the CSA's Article 17 (2) letter, the definition of public service broadcasting.

The Icelandic authorities have a wide margin of discretion regarding which services it considers as services of general economic interest within the meaning of Article 59(2) of the EEA Agreement. According to 24C.6.1 (2) of the Broadcasting Guidelines, a wide definition may be considered in the specific case of broadcasting. However an activity should be considered to meet the democratic, social and cultural needs of a society, guaranteeing pluralism, including cultural and linguistic diversity.

According to 24C.6.1 (3) of the Broadcasting Guidelines this can also include services which are not programmes in the traditional sense, such as online information services, to the extent that while taking into account the development and diversification of activities in the digital age, they are addressing the same democratic, social and cultural needs of the society in question.

Article 3 of the draft National Broadcasting Service Act defines and entrusts the public service broadcasting obligation to RUV.

The CSA is of the preliminary opinion that Article 3(10) of the draft National Broadcasting Service Act does not pursue public service broadcasting objectives but rather seems to pursue regional objectives. Regional aid might be compatible as regional aid under Article 61 (3) c) in conjunction with the Authority's Regional Aid Guidelines, but would not qualify for aid as a 'public service compensation'. Without any further information, the CSA is not in a position to declare this objective compatible with the EEA State aid provisions and would thus appreciate further explanation on this provision.

Further, the CSA finds parts of the services mentioned in Articles 3(13) and 3(14) of the draft National Broadcasting Service Act to be commercial services. Reference is made to footnote 53 of the Article 17(2) letter of 3 June in which the CSA states:

"... in relation to the draft legislation on the Icelandic National Broadcasting Service the CSA is of the preliminary opinion that several of the activities mentioned in article 3 may be categorised as commercial activities. E.g. it follows from Article 3(14)(now 13) of the draft that the Icelandic Government is of the opinion that the operation of public service broadcasting involves compiling, publishing and distributing material of any type, either free of charge or in return for payment, that contributes toward the securing of RUV's objectives. Furthermore, according to Article 3(15)(now 14) RUV is in the future obliged to have selected material which previously has been broadcast available for loan and for sale".

The CSA wishes to stress that public service broadcasters can, without doubt, also engage in commercial activities. However, such commercial activities should not receive any public funding, as this would result in an unjustifiable distortion of competition. For that reason, the correct definition of public service activities is of the utmost importance and doubts as to whether the activities under Article 3 the draft National Broadcasting Service Act really constitute a public service must be taken seriously.

In order to achieve transparency, the CSA is in favour of a legal drafting technique which distinguishes the public service broadcasting obligations from other activities and to clearly separate them in different articles of the draft National Broadcasting Service Act (i.e Article 3, "public service broadcasting" and Article 4, "other activities"). As discussed in the meeting, the fact that an activity is not mentioned in Article 3 of the draft National Broadcasting Service Act does not necessarily mean that it cannot constitute a public service. Whether an activity constitutes a public service broadcasting activity (classical public service broadcasting or activities closely associated therewith) or alternatively, a public service in its own right not related to public service broadcasting or thirdly, a purely commercial activity, has to be judged on the merits. It is legally not excluded that other activities constitute a public service if they fulfil the criteria of Article 59 (2) of the EEA Agreement. Such dissociated (stand alone) public service activities need to be separated in the company accounts from commercial and the public service broadcasting activities.

The problem with the current drafting, however, is that Article 3 of the draft National Broadcasting Service Act under the heading 'public service broadcasting' contains activities which can hardly be justified as constituting public service broadcasting. This applies e.g. to the sales of CDs and videos, i.e. the commercialisation of the public service broadcasting, which according to the Broadcasting Guidelines clearly constitutes a commercial activity (see Chapter 24C.6 of the Broadcasting Guidelines). Their inclusion in Article 3 of the draft National Broadcasting Service Act gives the impression that such activities can be funded by state resources. This is in particular the case as Article 3 is referred to in Article 5 of the draft National Broadcasting Service Act, allowing for a financing of all activities mentioned in Article 3 by public funds. While that might not be the Icelandic authorities' intention, in the view of the CSA such drafting would easily give rise to misunderstandings, which should be avoided in order not to cause any state aid concerns.

Therefore, the CSA could – subject to a more detailed investigation - consider that a move of Articles 3(10), (13) and (14) of the draft National Broadcasting Service Act to Article 4 of the draft National Broadcasting Service Act, as tentatively suggested by the Icelandic authorities in the meeting, might be able to dispel the above concerns. Likewise it could be

envisaged that Article 7(2) of the draft National Broadcasting Service Act, for which the same question arises - whether the activities constitute real public service activities - is moved to Article 4 of the draft National Broadcasting Service Act.

Article 3 of the draft National Broadcasting Act would then define the public service broadcasting obligation RUV shall fulfil. Article 4 of the draft National Broadcasting Service Act could contain stand-alone public services other than broadcasting (which however, also need to be clearly defined and entrusted, see below, and which would be subject to separate accounting) and other activities RUV may enter into.

The CSA would like to receive information on whether a reformulation of the draft in this regard will be undertaken by the Icelandic authorities in order to deal with the above concerns.

Further, reference is made to point 2 on page 33 of the Article 17(2) letter. In the correspondence between the CSA and the Icelandic authorities, the CSA has understood that currently the performance management agreement between the Icelandic State and RUV can be obtained by the general public, in particular competitors of RUV, through the Icelandic Information Act. Given the above mentioned changes in the draft National Broadcasting Act, the CSA would like to receive information on the status of the performance management agreement between RUV and the Icelandic authorities, in particular whether this agreement would still continue to exist and which matters it would cover. Further, will the reorganisation of RUV from a public enterprise to a limited liability company change the publicity of the performance management agreement?

3.2 Entrustment - ex-ante mechanism for inclusion of new services into the public service remit

The following considerations are based on point 2 on page 32 and point 1 on page 33 of the CSA's Article 17 (2) letter.

The CSA is of the opinion that in situations in which the definition of the public service is broadly defined, the entrustment of (new) public services becomes decisive. Otherwise, the planning security of private competitors might be endangered. In this respect, the CSA is of the preliminary opinion that new services falling within the public service remit must be entrusted in a transparent way to RUV *before* they are introduced to meet the conditions set out in 24C.6.1.(4) of the Broadcasting Guidelines. This act of entrustment would then have to clearly define the tasks in question, not only for the sake of justifying their public financing need, but also to ensure supervision of the public service being carried out as provided for, see Chapter 24 C.6.2 of the Guidelines (see below, point 3.3)

The CSA notes that an ex-ante mechanism for inclusion of new services into the public service remit is currently not in place in Iceland. Subsection 2 of Article 3 in the former draft on the National Broadcasting Service Act contained an ex-ante mechanism whereby the Minister of Education, Science and Culture should specially approve new public services that are related in a natural way to the company's principal activities (i.e public service broadcasting). This provision has been deleted and is no longer part of the current draft.

The CSA is of the preliminary opinion that such a mechanism could fulfil the requirement of an *ex-ante* mechanism for inclusion of new services into the public service remit. The approval by the Minister, or another State body, would fulfil the criterion of entrustment by an official act, as stipulated in Chapter 24 C.6 of the Broadcasting Guidelines (see also Decision No. NN 88/98, "*financing of a 24-hour advertising free news channel out of the licence fee by the BBC*", paragraphs 60-61), where such an entrustment was done by the Secretary of State). However, it would be desirable if the special approval by the Minister of Education, Science and Culture or any other state body were made public beforehand in order to facilitate planning security for competitors.

The CSA would appreciate more information on how the entrustment of the provision of new public service broadcasting activities is envisaged by the Icelandic authorities.

3.3 Entrustment - supervision

The following considerations concern point 3 on page 32 and point 4 on page 33 of the CSA's Article 17 (2) letter.

Pursuant to section 24C.6.2.2 of the Broadcasting Guidelines, it is necessary that the service is supplied as foreseen in the entrustment act. To this extent, it is desirable that an independent authority or body be put in place in charge of monitoring its application.

To the knowledge of the CSA there is currently no *ex-post* supervisory mechanism in place in Iceland. In the meeting, the Icelandic authorities proposed that the *ex-post* supervision of the fulfillment of the public service obligation could be carried out by the Icelandic Auditor General.

The CSA does not question the independence of the Auditor General. However, the CSA would like to point out that the independence requirement is only a minimum requirement and not necessarily sufficient to ensure an effective *ex-post* mechanism.

The Icelandic authorities are kindly requested to submit information which demonstrates that the Icelandic Auditor General or any other state body chosen to carry out that supervision have formal competence to supervise the fulfillment of the public service obligation entrusted to RUV. Further, the Icelandic authorities are kindly requested to submit information that demonstrates the effectiveness of the *ex-post* supervision mechanism. This includes, in particular, the scope of the Auditor General or any other state body's assessment and the reporting obligations conferred upon the supervisory body. For example, would the Auditor General or any other state body report annually on the public service activities carried out by RUV on the basis of the entrusted public service obligation RUV is obliged to fulfil?

3.4 Proportionality

3.4.1 Separate accounting

The following considerations refer to point 4 on page 32 of the CSA's Article 17 (2) letter.

The Broadcasting Guidelines refer to the Transparency Directive² according to which the Icelandic authorities have been required to take measures to ensure – in cases where undertakings provide a service of general economic interest and receive state aid and carry out other, non-public service tasks – that there are separate accounts.

The CSA notes that neither the Transparency Directive in general has been implemented in Iceland nor has a separation of accounts within RUV been done.

If the CSA understand information given in the meeting correctly, the Icelandic authorities will soon communicate to the CSA that the Transparency Directive has been implemented into Icelandic law. The CSA would appreciate an update on that as soon as possible.

According to information presented by the Icelandic authorities, Article 5 of the draft National Broadcasting Service Act will require RUV to implement separation of accounts. The CSA is currently not sure about the precise meaning of Article 5 of the draft National Broadcasting Service Act, which might partially result from some translation difficulties. According to Chapter 24C.6.3.2.1, there should be a clear separation of accounts, which means that all revenues and all income for both of the public service activities and the non-public service activities should be listed separately so that costs and revenues of these three activities (public service broadcasting, stand alone services, and commercial activities) can be clearly distinguished. The CSA is not entirely certain whether the English word 'finances' in Article 5 of the draft National Broadcasting Service Act extends to costs and revenues in the meaning of Chapter 24C6.3.2.1 and would appreciate a clarification to that end.

Further, the CSA is not certain what is meant by the second sentence in Article 5 of the draft National Broadcasting Service Act, which states in the English translation that "*finances from activities under Article 3 might not be used to subsidise other activities, including competitive operations, unless the activities are classified as public service broadcasting as defined in Article 3 of the Act.*" Again, the word 'finances' is unclear in this respect.

According to the EEA state aid rules, state funding can be only used for public service activities (i.e. public service broadcasting activities or other stand alone public service activities), but under no circumstances for commercial activities. The CSA is not sure what the word 'finances' – which according to the Icelandic authorities are not to be used for such a cross-subsidisation of commercial activities - entails. In particular the CSA is uncertain whether the word 'finances' would, as it should, cover license fee funding or, in the present draft, the tax mentioned in Article 12 of the draft National Broadcasting Service Act. As Article 12 of the draft National Broadcasting Service Act only lists the income of RUV without delineating for which purposes the income can be used³, it is mandatory that Article 5 of the draft National Broadcasting Service Act provides for a clear stipulation that public state funding, whether direct or indirect, does not end up in the financing of commercial activities.

² Directive 80/723/EEC, OJ L 195, 29.7.1980, p. 35 incorporated into the EEA Agreement under point 1 of Annex XV, as amended by Directive 2000/52, OJ L 193, 29.7.2000, p. 75, introduced into Annex XV by Decision No 6/2001 (OJ L 66, 8.3.2001, p. 48 and EEA Supplement No 12, 8.3.2001, p. 6), e.i.f. 1.6.2002.

³ It lists a special fee (which could only be used for the public service, as it in the CSA's preliminary view would constitute state resources), advertising and other income.

Likewise it is not entirely clear to the CSA, whether the 'other income' mentioned in Article 12 of the draft National Broadcasting Service Act would concern state resources. If so, these may only be used for public service financing.

As a result of the meeting, the CSA finds it also useful to confirm to the Icelandic authorities that while the cross-subsidisation of commercial activities by direct or indirect advantages granted via state resources is forbidden, an inverse cross subsidisation of the public service by other income is allowed. For commercial revenue resulting from the exploitation of public services, the Broadcasting Guidelines even stipulated that this money must be taken into account to assess the need for public funding.

3.4.2 Net public service cost

This section refers to point 5 of page 32 and point 3 on page 33 of the CSA's Article 17 (2) letter.

It follows from section 24C.6.3.3. (1) of the Broadcasting Guidelines that the state aid must not exceed the net costs of the public service mission. To arrive at the net cost, account should be taken of other direct or indirect revenues derived from the public service mission. Therefore, the net benefit of the exploitation of the public service activities needs to be taken into account when assessing the proportionality of the aid. This would concern revenues from commercial activities within RUV, but also, if RUV were ever going to operate with commercial subsidiaries, revenues generated by those commercial subsidiaries as far as their revenues are directly or indirectly linked to the public service carried out by RUV.

To the knowledge of the CSA, there is no transparent mechanism in Iceland whereby net revenue from commercial activities directly or indirectly related to the public service remit is taken into account when calculating the compensation needed to cover the cost of discharging the entrusted public service obligation.

Therefore, the CSA cannot be certain – without any provision on the cost and revenue allocation – if this also takes into account commercial revenues, thereby fulfilling the requirements of the Broadcasting Guidelines.

3.4.3 Anticompetitive behaviour in commercial markets

The following remarks refer to point 6 on page 32 of the CSA' Article 17 (2) letter.

A side effect of the public service compensation might be that other market distortions occur which is not necessary for the fulfillment of the public service mission. As a result of the state financing of public service programs, the public broadcaster might be in a position to act in an anti-competitive way, by undercutting competitors in the commercial markets. The CSA therefore has to analyse whether the legal framework of RUV contains appropriate safeguarding measures to prevent overcompensation of RUV public service obligations.

Firstly, the CSA notes that RUV does not have any internal guidelines on how to conduct commercial activities nor do such rules seem to be established in other legislative or administrative acts.

Secondly, to the knowledge of the CSA, there is no independent body which is obliged to regularly check RUV's behaviour in commercial markets e.g. advertising or purchasing of programme material.

The National Auditor carries out a performance review of RUV. Performance audits cover the handling and utilisation of public funds, whether economy and efficiency is being taken care of in the operations of institutions and state owned enterprises and whether applicable lawful instructions are being complied with in this context. However, at the present stage of the proceedings, the CSA does not have enough information on the scope of the performance audit, in particular if it covers the commercial behaviour of RUV. Without this information, the CSA cannot come to the conclusion that a sufficient supervision system has been established.

In case of any further queries, please contact, *Ms. Annette Kliemann +32 (0)2 286 1880* or *Mr. Espen Bakken +32 (0)2 286 1818*.

The Icelandic authorities are kindly requested to answer all the abovementioned questions or provide information as indicated within 20 working days from receipt of this letter.

Yours faithfully,



Amund Utne
Director
Competition and State Aid Directorate