Better Downstream Regulation through a More Refined State Aid Law Approach!

A lot of wood has been cut by the paper industry to print abstracts on the State Aid Action Plan (SAAP) and its Less and Better Target-Oriented State Aid Approach. Indeed, its "roadmap" guides us through some long and winding roads of economic thought, but leaves its practical impacts on the case law in the dark. If State aid, as regulation in general, is intended to remedy market failures, as distinguished sharply from government failures, due to, inter alia, externalities, public goods, imperfect competition, natural monopolies, asymmetric information etc., it appears crucial to define and analyze precisely the environment of the respective failure, i.e. the neighbouring as well as the relevant upstream and downstream markets. These neighbouring/upstream/downstream market environments are rather complex, as experienced, inter alia, by potentially distortive interactions between broadband network funding and services favouring, between airport funding and airline favouring, between hospital funding and the favouring of specific medical service providers, cross-subsidization in the universal postal services or the public transportation sectors. However, the relevant case law and soft law (e.g. the Commission's guidelines on broadband funding or on the financing of airports and start up aid to airlines) do not provide us with a consistent "roadmap" for a long and safe ride through the winding roads of Member States' funding jungles.

The public funding of undertakings engaged in the development and the setup of infrastructures (direct beneficiaries on the upstream market) may result in benefits of undertakings using the new infrastructures (indirect beneficiaries on the downstream market). According to the Commission's decision of 24 January 2007 in the case *Decoder* (2007/374/EC; OJ L 147/2007), the indirect beneficiaries' advantage may infringe Article 107 (1) TFEU, even if the public funds granted to the direct beneficiaries are not to be regarded as State aid. On assumption of public intelligence, the *Decoder* decision could send appropriate signals to the Member States' political class of infrastructure junkies, for instance with regard to regional airport funding in the plain pampa. However, public intelligence is a scarce resource, and the methodology behind the *Decoder* decision is left in the dark. The lack of methodology is also evidenced by the Commission's guidelines for the application of State aid rules in relation to rapid deployment of broadband networks' (OJ C 235/2009) as compared to the guidelines on the financing of airports and start-up aid to airlines departing from regional airports (OJ C 312/2005). The broadband guidelines affirm in paragraph 14 the *Decoder doctrine*, i.e. the possibility of State aid effects, due to distortive downstream favouring, even if the network investor is chosen under upstream market terms in an open tender:

> *"While the use of a tender ensures that any aid is limited to the minimum amount necessary for the particular project, the financial support might enable the successful bidder to conduct a commercial activity on conditions which would not otherwise be available on the market. Indirect beneficiaries might include third party operators that obtain wholesale access to the infrastructure thus built, and also business users who get broadband connectivity under terms and conditions that would not apply without State intervention."*

By contrast, the leverage of upstream infrastructure funding (under appropriate market/tendering terms) onto downstream benefits is not even addressed in the guidelines on the

financing of airports and start-up aid to airlines departing from regional airports. The *Ryanair – Charleroi airport*, *Ryanair – Bratislava airport* and *DHL – Leipzig Halle airport* cases (see *Balfour/Leandro*: "State Aid in the Airline Sector", 10(2) *EStAL* (2011): pp. 225–236) provide, as well, evidence for a lack of regulatory sensitivity and consistency in methodology with regard to the leverage of upstream infrastructure funding onto downstream benefits.

The more rigid approach in the broadband sector can be explained by the Commission's strategy to reserve its unilateral regulatory downstream options under Articles 107, 108 TFEU, while being restricted to rather complicated consolidation measures (only) in cooperation with the National Regulatory Authorities in upstream telecommunication access markets under the sector-specific Directive 2009/140/EC on a common regulatory framework for electronic communications (Arts. 7, 7a). Any access remedy imposed under the aforementioned Directive by a National Regulatory Authority (not by the Commission) requires proof of "significant" (dominant) market power of the regulated undertakings on the access markets (Arts. 14–16). Therefore, keeping the hidden regulatory downstream options for unilateral Commission's interventions under Articles 107, 108 TFEU appears intelligent, but not coherent compared with other infrastructure sectors.

However, without a general (not a mere sector-specific) methodology of defining the neighbouring as well as the relevant upstream and downstream markets (from the perspective of the directly funded markets and vice versa) a correct assessment of favouring and distortive effects is not possible. The case law on merger control can serve as a tool kit for State aid law (e.g. the hypothetical monopolist test or SSNIP test = Small but Significant and Non-transitory Increase in Price). Of course, methodological adjustments are necessary. The balancing test under the SAAP focuses on the measuring and weighing of positive and negative effects caused by State funding, thus requiring a distinguished analysis of the effects on consumers and producers, upstream and downstream. This exercise is crucial, if the vertically integrated infrastructure producer (as direct beneficiary of upstream funding) is active, as well, on downstream (services) markets.

As *Haucap* and *Schwalbe* have pointed out (DICE Discussion Paper No 17, April 2011, www.dice.uni-duesseldorf.de), the reversed phenomenon of the "cellophane fallacy" can occur in the context of State aid: Under the general terms of the relevant product market definition according to Articles 101, 102 TFEU and merger control, the consumers may consider products as substitutes due to excessive prices, which are not substitutable under competitive prices, thereby defining the relevant market too broadly. If, by contrast, upstream public funding artificially decreases the price level below the competitive analogue (cost oriented) price, a reversal of the "cellophane fallacy" will be observed, e.g. in fixed broadband retail services markets benefitting from upstream-funded (fixed) infrastructures owned by municipal network companies like the German "Stadtwerke". Thanks to the artificially low prices, consumers are not willing to consider alternative products, e.g. mobile broadband services, which they would have demanded as substitutable, if the fixed broadband services were offered at a higher, non-funded, competitive analogue market price. Under State aid driven terms of the reversed "cellophane fallacy", the relevant product market is defined too narrowly, as important substitutes (mobile broadband services) are not included in the relevant product market. As new substitutability between products often overcomes a traditional path dependency, State aid will even hinder technological innovation due to the rever-

sal of the "cellophane fallacy", if the consumer does not switch to the more innovative product because the old one is priced artificially low under State-funded conditions. The reversal of the "cellophane fallacy" with its distortive and crowding out effects is likewise crucial with regard, inter alia, to the interactions between (regional) airport funding and airline favouring (distortion of intermodal competition between railway and airline services), between hospital funding and the favouring of specific medical service providers, cross-subsidization in the universal postal services or the public transportation sectors.

Furthermore, cross-border effects of public funding require a more refined definition and analysis of the relevant geographic market, as well as of the impacts of potential competition. The latter should be taken into account in defining the relevant market and not, as in other fields of competition policy, within the assessment of the competitive (distortive) effects.

Those who write the case law and the soft law might reconsider their *legal* methods and integrate a consistent assessment of neighbouring as well as upstream and downstream markets in a more refined State aid law enforcement.

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