BT Group plc ("BT")

Response to the European Commission consultation on draft
EU Guidelines for the application of state aid rules
in relation to the rapid deployment of broadband networks

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1. Introduction

BT is grateful for the opportunity to respond to the consultation on the Commission's draft new EU Guidelines.

On 31 August 2011, BT submitted its comments on the Commission's plans to revise its existing Guidelines. This response builds on and complements those comments which are still of the utmost relevance to the current consultation. The draft new Guidelines do, however, raise some new issues, including the provisions relating to State aid approval for ultra-fast broadband networks, which we cover in this response.

We are concerned that State aid approval decisions already appear to have been made on the basis of such provisions in the *draft* Guidelines; for example, the recent City of Birmingham decision.[1] Our understanding is that the Commission should comply with its existing guidelines until such time as the consultation on the new draft guidelines is complete.

The most important points of principle that the new guidelines should observe are

- State subsidy should not be permitted for the building of networks where commercially financed networks are already deployed or expected to be deployed within a reasonable timescale
- There must be fully effective wholesale access to state subsidized infrastructure, but the nature of wholesale access requirements must be consistent with the regulatory requirements prevailing in the member state in question
- State subsidized assets should not be used to distort competition in unrelated markets e.g. business connectivity markets
- The guidelines should not attempt to require or remove specific technical solutions via overly prescriptive requirements.
- A balance must be struck between preserving an incentive for the private sector to invest in infrastructure and promoting competition via access to that infrastructure.

These key principles are addressed in more detail in the remainder of our response.

Central to the Guidelines, and to any State aid approval, is the need to ensure that effective wholesale access is offered by any operator in receipt of public funding. BT fully supports this principle but we remain of the view that it is neither necessary nor efficient for <u>all</u> different types of network access to be provided by the recipient of public funds for NGA deployment as a condition of state aid approval. It is essential

[1] State aid SA.33540 (2012/N) – United Kingdom: City of Birmingham – Digital District NGA Network.

for the EU2020 strategy, and in line with Commission policy[2] on enhancing broadband investment, that disproportionate access conditions should not deter NGA network investment in areas where commercial rollout is unlikely.

BT therefore believes that an overriding consideration should be whether or not the particular form of network access requested, taken individually and together with other access requests, a) provides fully effective wholesale access and b) does so without removing the investment incentive for network operators. If this is not the case, then there should be no obligation to provide that particular form of access concerned.

For example, in the UK, BT already provides a proportionate combination of active and passive access to its NGA networks (via its Virtual Unbundled Local Access ("VULA") product (which allows operators to deliver services over BT's NGA network, with a degree of control that is similar to that achieved when taking over the physical line to the customer) and also via its Physical Infrastructure Access ("PIA") product (which provides direct access to BT's ducts and poles), together with the functional separation of BT's local access network, both on subsidized networks in predominantly rural areas and on those financed wholly from BT's own funds. This combination delivers vibrant downstream competition, which is unmatched across Europe, while allowing investment to be contestable and sustainable[3]. Additional passive access is therefore unnecessary: for example, a dark fibre obligation has to date been considered disproportionate and inappropriate in the UK, as BT mentioned in its earlier comments and as endorsed by Ofcom[4] and the European Commission[5]. The Commission should not impose conditions, such as dark fibre, which conflict with the approach to the promotion of competition taken by the NRA.

2. NGA Network access conditions – the draft Guidelines fail to strike the right balance

Encouraging investment in new, high-speed infrastructure is one of the main objectives of the Europe 2020 Strategy and is shared by all of the Commission's Directorates General including DG Competition. The granting of public funds to

[2] "Enhancing the broadband investment environment – policy statement by Vice President Kroes" 12 July 2012

[3] CPs such as Sky and TalkTalk and some 60 plus service providers are using VULA to gain access to FTTC and FTTP. FTTC speeds have grown from 40/10Mbps (download/upload) to 80/20Mbps while speeds on FTTP have increased from 100/20Mbps to 330/30Mbps.

[4] "Delivering superfast broadband in the UK", Ofcom, March 2009, paragraph 6.2: http://stakeholders.ofcom.org.uk/binaries/consultations/nga_future_broadband/statement/statement.pdf; and "Review of the Wholesale Local Access Market", Ofcom, 2010, paragraph 6.90: http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf

[5] Commission comments on the WLA Statement, page 8: http://stakeholders.ofcom.org.uk/binaries/consultations/wla/responses/european-commission.pdf

subsidise the costs of new infrastructure and a proportionate application of the State aid rules are indispensable for delivering this objective in areas which otherwise would not attract private sector investment[6].

At the same time as encouraging investment in infrastructure, EU2020 aims to achieve effective competition in communications services on that infrastructure by allowing access to it by competing operators.

To meet these twin objectives, the Commission's Guidelines should promote access conditions which preserve the incentive for access givers to invest in subsidized infrastructure, by ensuring that they can make a reasonable return on their investment, while ensuring effective competition in communications services.

There is a delicate balance to be struck. Multiple layers of network access or the provision of access at too low a price undermines the incentives to invest and will deprive large areas of the UK of NGA networks and services.

Indeed, the Commission itself is required to carry out a balancing test when deciding whether to approve aid for NGA infrastructure under Article 107(3)(c) TFEU and to satisfy itself that the proposed aid produces an incentive effect by encouraging operators to make infrastructure investments they would not otherwise make.

The draft Guidelines fail the Commission's own balancing test by removing this incentive effect. In particular, the draft Guidelines:

i. appear to require that subsidized infrastructure should support effective and full bundling and satisfy all different types of network access that operators may seek;
ii. require subsidized infrastructure to be available to access seekers to supply any type of service they want including non-broadband services such as leased lines;
iii. seek to impose new access obligations at the bid stage on existing infrastructure which has not been subsidized; and
iv. require full unbundling of point-to-multipoint technology using Wavelength Division Multiplexing in contradiction to principles of technology neutrality.

On this basis, the draft new Guidelines defeat DG Connect's twin policy objectives of encouraging investment in high-speed communications infrastructure while delivering effective competition in communications services on that infrastructure through appropriate access conditions.

These practical and legal concerns are examined in more detail below and BT makes a number of suggestions as to how they can best be addressed. BT also

[6] Draft Guidelines, paragraph 2: "… the [Digital Agenda for Europe] objectives cannot be reached without the support of public funds. For this reason, the DAE calls on Member States to use "*public financing in line with EU competition and State aid rules*" in order to meet the coverage, speed and take-up targets defined in EU2020".

discusses below other difficulties with the draft Guidelines, such as the proposals for ultra-fast broadband networks.

(i) Failing to strike the right balance - all different types of network access

If the Commission's intention is to retain the requirement for "*all different types of network access that operators may seek*"[7], then BT would emphasise that this is unnecessary and, indeed, counterproductive. Such a requirement envisages no limit on the access obligations of the investor and paves the way for multiple competing networks. In so doing, it removes the incentive for operators to invest their free cash in subsidized networks because it reduces the potential revenues available to cover the costs of each network (this is particularly problematic in sparsely populated areas). In any intervention area, there is a finite number of end-users. The number of end-users using a new network, and therefore the available revenues, will fall if the network is duplicated. In many instances, available revenues will fall below investment cost. In some areas, it may only be profitable for single network to be installed.

Limitless access obligations also increase the investment and operating costs. Such costs rise every time the access giver has to develop and supply a new access product. The Commission recognizes this to a certain extent in its draft Guidelines[8]:

"… *in rural areas with low population density, where there are limited broadband services, the imposition of all types of access products might disproportionately increase investment costs without delivering significant benefits in terms of increased competition*".

Unfortunately, the solution to the problem proposed in the draft Guidelines, the application of a "*reasonable demand*" test, does not go far enough. The test should also be whether or not the investment incentive is removed.

As indicated, the final version of the Guidelines should recognize that it is not appropriate or necessary to impose an obligation to supply all types of access that operators may seek. Other models are available to deliver effective competition, such as VULA in the UK. BT's experience of VULA is that it is the most attractive form of network access to other providers in sparsely populated rural areas because of its design and cost effectiveness. VULA enables LLU and other operators to access end-users in small and remote local exchanges with minimum up front capital investment due to the installation of 'handover points' in the larger exchanges.

[7] Current Guidelines, paragraph 79, third indent.
[8] Draft Guidelines, paragraph 67(g), third sub-paragraph.

The suggested 'one size fits all' approach in the draft Guidelines is not the most effective way of delivering NGA networks in all Member States. There must be sufficient flexibility in the final version of the Guidelines to allow different combinations of active and passive access designed to take account of local investment conditions.

On the other hand, the new draft Guidelines do seem to suggest that the requirement for "*all different types of network access that operators may seek*" to be available on the subsidized NGA network may no longer apply. The new draft Guidelines say[9]:

"*Third party operators must therefore have access to passive and not only active infrastructure. Apart from bitstream access and unbundled access to the local loop, the access obligation should therefore also include the right to use ducts and poles, dark fibre* ***or*** *street cabinets*" (emphasis added).

The use of the conjunction '*or*' rather than '*and*' suggests that these types of passive access are alternative rather than cumulative. Whether this choice of wording is intentional or not, the Commission should make it clear that it is no longer insisting on all types of passive access being available on the subsidized NGA network. Instead, an appropriate mix of active and passive obligations should be applied to take account of the existing economic and legal context in each intervention area.

In considering the appropriate level of network access, distinction should be made between 'municipal' models (where new duct and other access networks are fully funded by local government) and 'co-funding' models (where gap funding is provided to private investors who own existing networks). In the former situation all types of access may well be appropriate as the case to invest in the first place does not have to be made other than by the government. In a co-funded or gap funded model the private investment incentive is of course vital and anything that dilutes this will increase the cost to government.

(ii) Failing to strike the right balance – allowing subsidized infrastructure to be used for the supply of non-broadband services

The distinction drawn between 'white', 'grey' and 'black' areas in the Current Guidelines and the draft Guidelines is an application of the principle that aid cannot be compatible with the internal market if it is used to duplicate existing or planned basic broadband or NGA networks which the private sector will deliver in any event. This is a principle BT fully endorses.

In such circumstances, where the network investment has been or will be made by one or more private sector investors within the same timeframe, state aid should

[9] Draft Guidelines, paragraph 76(b).

not generally be permitted i.e. in black areas there is no case for state aid and in grey areas only after a detailed analysis and compatibility assessment to determine that there would be no adverse impact. Otherwise there is no "incentive effect" to encourage commercial investment in NGA networks.

Duplication of private sector investment with public money is also disproportionate because it increases rather than minimizes the amount of public sector expenditure.

Overall, duplication with public funds distorts competition to the detriment of existing operators, outweighs any positive impact of the aid and cannot benefit from Commission approval under Article 107(3)(c) TFEU.

Non-duplication of private sector investment in non-broadband services: Similarly, for the reasons just given, aid will not produce an incentive effect if it is used to duplicate other services, such as Ethernet services, which the private sector has already delivered or will deliver within a reasonable timeframe.

The Commission should make it clear, therefore, that the use to which wholesale access to subsidized networks is put must be consistent with this principle. Consequently, the following statement in the draft new Guidelines[10] should be qualified:

" *… any access obligations imposed by the aid granting authority should … not be subject to any limitations. … For instance, the usage of wholesale access by third parties cannot be limited only to retail broadband services*".

The qualification required is that wholesale access to subsidized infrastructure can only be used by third parties to supply services other than NGA broadband <u>provided that:</u>

(i) such non-broadband services are not already available or planned in the area concerned;
(ii) third parties commit to and in fact deliver broadband services as well; <u>and</u>
(iii) overall the effect of this use is not to remove the incentive for operators to invest in the network in the first place.

Consequences of failing to apply the non-duplication principle to non-broadband services: allowing third parties to use access to subsidized infrastructure to supply non-broadband services where such services are already available or planned produces a number of unlawful disincentives to investment which all work against the realization of the Digital Agenda for Europe and EU2020.

[10] At paragraph 67(g), second paragraph and footnote 95.

First, it puts at risk the revenues of all commercial operators who are supplying the non-broadband services in question and distorts competition in sectors which are not the focus of the State intervention and where there is no identified market failure.

Secondly, it removes the incentive for network operators to invest in NGA infrastructure subsidized by the public sector because of the potential negative impact on those operators' revenues from non-broadband services if providing this unqualified access is a condition of funding.

Thirdly, if an operator nevertheless decides to bid for public funds towards the deployment costs of an NGA network, it will have to factor into its investment cost the risk of lost revenues in other sectors. This increases the bid price, distorts the bidding process and increases the amount of public subsidy required. Alternatively, the bid price is not increased but the NGA coverage that can be achieved with the available funding is reduced. In either scenario, the Commission's own objectives of maximizing broadband coverage and making efficient use of public funds are not met.

Commitment to deliver NGA broadband services: if operators were allowed to use wholesale access to subsidized infrastructure to supply any service they please, there is no guarantee that they would use it to supply basic broadband or NGA services. Instead, they might use the access to supply, say, leased lines to business customers and not for broadband at all. In this way, the access would not contribute in any respect to remedying market failure in broadband, the "well-defined objective of common interest" which Article 107(3)(c) TFEU requires the aid to achieve, but would contribute to distorting competition in sectors where no market failure has been identified.

This is a disproportionate result which fails the Commission's balancing test under Article 107(3)(c) TFEU. To avoid this outcome and to satisfy the requirement for achieving the objective of common interest – the delivery of NGA - access seekers who wish to supply non-broadband services on subsidized infrastructure must be required to commit to provide a market ready, long term NGA service covering a material proportion of premises in the intervention area concerned.

(iii) Failing to strike the right balance – access to existing infrastructure at the bid stage

The new draft Guidelines seek to impose new access obligations at the bid stage on existing infrastructure which has not been subsidized. The draft Guidelines say[11]:

"*Any operator which owns or controls infrastructure (irrespective of whether it is actually used) in the target area and which wishes to participate in the tender, should*

[11] Ibid, paragraph 67(f).

fulfil the following conditions: (i) to inform the aid granting authority and the NRA about that infrastructure during the public consultation; (ii) to provide access to such infrastructure to all other potential bidders at the same terms and conditions as the operator uses them for its own tender; (iii) to provide all relevant information and access to other bidders at a point in time which would allow the latter to include such infrastructure in their bid".

The proposal, in particular, to oblige bidders to give access to their infrastructure to all other bidders on the same terms and conditions as they apply to themselves is significant disincentive to operators to take part in any bid. It is also a disincentive to invest in infrastructure. Moreover, it is an access obligation imposed on a network that has been built without public subsidy. Competition law and regulation should decide whether or not an infrastructure owner has to provide access in these circumstances and, if so, on what terms.

(iv) Failing to strike the right balance – point-to-point, GPON and full unbundling

BT is still of the view, expressed in its earlier comments, that GPON (point-to-multipoint) is more cost effective, both as far as capital investment and ongoing operational expenditure are concerned. According to Ofcom, there is a lack of clear demand for multi-fibre point-to-point investment in the UK market and an obligation to unbundle GPON to facilitate this would discourage investment. By contrast there is already evidence in the UK of major alternative operators taking advantage of the ability to access point-to-multipoint fibre connections at the network level and competing effectively downstream with BT.

Even if such demand does materialize, a properly designed GPON network will be capable of delivering multi gigabit connections to all locations without the need to replace the fibre connections. There may be a need for additional high speed electronics as demand increase, but this is a very low cost upgrade in relative terms and certainly more cost effective than full point-to-point fibre that may never be needed.

The final version of the Guidelines should state that network operators can choose which technology they wish to use, including GPON. This is already alluded to[12] but needs to be made clearer. Indeed, because it is more cost effective, GPON requires less public funding than point-to-point.

The final Guidelines should confirm that there is no requirement to unbundle GPON and qualify the draft Guidelines which currently provide[13]:

[12] Ibid, footnote 108 "[publicly financed NGA networks] shall be able to support both point-to-point as well as point-to-multipoint topologies depending on the choice of the (third party) operators".

[13] Ibid, paragraph 76(b) and footnote 103.

"*The subsidised network … will provide [operators] with the possibility of effective and full unbundling. … If the selected bidder rolls out a point-to-multipoint topology network, it shall have a clear obligation to provide effective unbundling via wavelength division multiplexing (WDM) as soon as the access is standardized and commercially available*".

A blanket unbundling obligation such as this is another disincentive to investment by operators in subsidised NGA networks. It is also not an effective means of promoting alternative investment and competition: it is better to decide on the most effective wholesale access condition, in order to provide the foundation for alternative investment and competition, than to impose all forms of wholesale access obligation simultaneously. They may all be rendered ineffective, because they are poorly implemented or mutually incompatible or economically unviable, and consequently not provide a basis for effective alternative investment and competition.

The Commission should be guided by NRAs as to what is the most effective form of wholesale access to promote competition in those member states. The competitive, regulatory and market conditions are different in different member states. The Commission should be guided by the approach of the authorities that have invested many years in understanding and promoting effective competition.

In accordance with the principle of technical neutrality, the Commission should not pick technology solutions. In particular, it should be noted that WDM is a far from proven technology for such unbundling and may not be the most efficient way of providing access in the future as network and technologies mature. Additionally, specifying a particular means of accessing GPON in the future is not consistent with the principle of technology neutrality and risks constraining options for future access.

3. Other issues with the Guidelines

Aid to ultra-fast broadband networks: The draft new Guidelines propose criteria for approving aid to so-called "ultra-fast" broadband networks[14]. Amongst other things, it is suggested that such criteria include the possibility of symmetric speeds, the extension of fibre to customer premises, support for infrastructure based competition and operation of subsidized networks as wholesale only networks.

The criteria are drafted in such a way that removes technology neutrality since they exclude technologies other than fibre based networks. At this stage it is not proven that fibre to the premises, either via GPON or Pt to Pt is an economically viable technology solution. In the UK, for example, BT is testing ultra-high speed broadband solutions which have the potential to deliver 1Gbs over copper more cost effectively and speedily than FTTP. The Commission does not have the relevant technology information to impose particular technology solutions.

[14] Ibid, at paragraphs 54 and 77 to 79.

The definition of ultra-fast broadband is also problematic as it risks confusing NGA services, which are the subject of Commission policy imperatives, with leased lines and other business services. This is likely to lead to State aid approval being granted for schemes which distort these adjacent markets. As previously indicated, the recent Commission decision approving State aid funding in Birmingham[15] has leant heavily on these *draft* new Guidelines with the justification for the scheme resting largely on concerns about the pricing of leased lines already commercially provided in the areas in question, rather than the lack of superfast or ultra-fast broadband networks.

The proposal that the networks in receipt of public funding should be *wholesale* only also needs to be clarified. Network owners must be able to benefit from aid for ultra-fast broadband and supply ultra-fast broadband at the retail level provided that non-discriminatory wholesale access is given to other operators. The exclusion of vertically integrated bidders would distort competition in the bidding process for aid for ultra-broadband networks and potentially result in increased subsidy. The Birmingham decision states that '*if the selected operator wishes to provide retail broadband services, it can do that through a legally and functionally separated company'.* This position rules out BT (a vertically-integrated company with strong functional as opposed to legal separation) and all the other major retail communications providers from bidding. Across Europe, such a stance effectively removes the vast majority of companies who are currently investing billions of euros of their own money into existing NGA networks from benefitting from future funding. If the wording in the draft Guidelines is deliberate with the intention of prohibiting certain types of provider from access public funding, then this introduces a distortion to the competitive process to the likely dis-benefit of the taxpayer.

Open topology: The new draft Guidelines propose that[16]:

"… *publicly financed NGA networks [should] allow an open topology network architecture that is able to support different topologies. … For instance, it shall be able to support both point-to-point as well as point-to-multipoint topologies depending on the choice of the (third party) operators*".

BT does not believe that the Commission intended for this obligation to apply to existing infrastructure, such as ducts and poles, because of the significant cost of transforming existing infrastructure into an 'open topology network' as described by the Commission. This point requires clarification in the final version of the Guidelines.

[15] [15] State aid SA.33540 (2012/N) – United Kingdom: City of Birmingham – Digital District NGA Network.
[16] Ibid, paragraph 76(c) and footnote 108.

Passive and neutral infrastructure: Another condition of public funding for NGA infrastructure set out in the new draft Guidelines is as follows[17]:

"*The State aid will be limited to … passive and neutral NGA infrastructures*".

The conjunction '*and*' is confusing because it suggests that no aid will be available for subsidized infrastructure which offers '*active*' access. The final Guidelines should make it clear that aid is available for NGA infrastructure offering active and passive access.

As far as the neutrality of the NGA infrastructure is concerned, the draft Guidelines refer to "*adequate safeguards*" being put in place to prevent any conflict of interest, undue discrimination or other hidden indirect advantages. The final Guidelines should make it clear that functional separation of the NGA infrastructure, for instance, by using BT's Openreach model provides the adequate safeguards the Commission requires.

4. Inconsistency with EU policy on fibre networks

Over the last 12-18 months the Commission has recognized that existing policy and legal instruments are not in themselves sufficient, or necessarily appropriate, to deliver high-speed broadband, and has agreed on a holistic package of measures aimed at encouraging investment, with key principles set out in Commissioner Kroes' July Policy Statement[18]. The draft Guidelines do not align with this new approach in a number of key areas, and appear to promote a model of NGA deployment that is also at odds with emerging market and technology reality. BT believes the following are particularly important examples of this divergence and are ones that need to be addressed before the draft Guidelines can be finalised.

1. <u>Encouraging sustainable competition and efficient investment</u>. The draft Guidelines focus on encouraging multiple competing fibre networks – this neither supports sustainable retail-level competition nor an efficient use of capital investment.

   Access conditions which allow for infrastructure duplication beyond the efficient level remove the investment incentive, but by insisting upon unlimited access to subsidized infrastructure the Guidelines would go beyond this efficient level. Moreover, reduced revenues inevitably follow from infrastructure duplication, and investment costs increase every time an investor has to develop and supply a new access product. The draft Guidelines exacerbate this by encouraging access seekers to use subsidized infrastructure to supply non-broadband services, such as leased lines. This

[17] Ibid, paragraph 76(a).
[18] Enhancing the broadband investment environment – 12 July 2012

has an adverse impact on the infrastructure owner's revenues in other non-broadband sectors.

2. A more sophisticated balance between access obligations and encouraging investment. The draft Guidelines apply a blanket approach imposing all types of access remedy without regard to cost or benefit. Mrs Kroes rightly observes that "securing truly equivalent access … is probably the most important guarantee of sustainable competition[19]" but the Guidelines do not admit of such an approach.

3. Technology Neutrality. One of the key lessons learned by most stakeholders over past years and fully endorsed by Commissioner Kroes proposals on enhancing broadband investment is that policy-makers should not pick winners. The Guidelines seem to ignore the widespread market evidence and still attempt to impose a specific – and more expensive – technology model. The treatment of 'ultra-fast' in the Guidelines further compromises this principle.

4. The right "buy or build" investment signals. Much of the Commission's work on regulation in the last 1-2 years has focused on this issue. The draft Guidelines would distort these signals where public funding is used, by excluding vertically integrated operators in for example urban areas, and by allowing funding for non-NGA service provision.

5. Cost-reduction. The Commission has launched an important initiative aimed at reducing costs of rolling out high-speed networks, and yet the draft Guidelines propose measures which would add costs, with no commensurate benefit.

6. Investment risk. A further difficulty, highlighted by Charles River Associates[20], is the asymmetry between the risk taken by the infrastructure owner, the access provider, and that taken by the access seeker. If demand for services on the new infrastructure is less than expected then the access provider takes all the risk. But if demand is higher then the access provider shares the benefits with the access seeker. Access seekers should share the demand risk, for instance, in the price that they pay for access. The draft Guidelines are silent on this question.

While the regulatory focus of DG Connect is of course on SMP conditions within the commercial market, the policy principles expressed above are all of equal relevance to the application of state aid. It is also essential to differentiate issues arising and

[19] Ibid

[20] Charles River Associates was commissioned by DG Connect to undertake a study on the optimal access pricing regime for fibre, taking into account the effect of access prices on investment incentives.

conditions which may be appropriate in a wholly public-funded (passive) network, from those in a ‘gap-funded’ model which is closer to commercial/SMP conditions.