



House of Commons
Committee of Public Accounts

The rural broadband programme

Twenty-fourth Report of Session 2012–13

Volume II

Written evidence

*Ordered by the House of Commons
to be published 17 July 2013*

Committee of Public Accounts

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Written evidence

Written evidence from VILLAGENETWORKS

My apologies for the delay, I trust we are not entirely too late to tender our submission, given today's date.

Please find attached our short submission to the Committee. As a rural wireless broadband provider of some 10 years standing, we have first-hand experience of the matters raised in the submission.

The phrase "last 10%" gives the impression that the most remote, or hardest-to-reach communities are not a priority, and can wait. There is now a strong argument that they are not only the most deprived, but the most needy, and should be seen as "the first10%".

We are not a unique organisation. We may be older and bigger than other rural wireless network providers, but there are others who do the same work. The launch of the BDUK NGA programme appears to be working against that last 10%, by excluding the one technology that can connect them quickly and cheaply, with much better broadband than they currently have.

We do not write with any sense of "sour grapes". We are busy and profitable providers of our service. Rural impatience for broadband continues to grow, and the creeping realisation that the last 10% may have to wait a long time, for not very much, only serves to heighten that impatience. Our workload connecting rural subscribers continues to grow.

We write because we are in daily contact with the broadband-deprived, and because we understand the increasingly significant disadvantages of that deprivation. As we pointed out—more than once—in our submission, the BDUK NGA Programme is set to make, in broadband terms, the rich richer and the poor poorer. By its own standards, there is no need, nor any good reason, for that to be the case, save for BDUK's apparent and unjustified obsession with capacity before coverage.

Thank you for accepting our submission.

WHY THE BDUK INITIATIVE IS MAKING THE DIGITAL DIVIDE WIDER AND DEEPER

SUMMARY

The BDUK SuperFast programme effectively ignores technologies other than those provided by BT, to the detriment of the most needy communities. It sets performance standards which in many cases are above and beyond useful application or need, yet which call for highest up-front investment.

Combined with the very low minimum performance standards set for "the last 10%", the outlook for the "last 10%" is bleak. Those who already have relatively fast connections will soon have even faster connections, while those who are already suffer the greatest broadband deprivation will have to wait even longer, for a not-much-better connections.

BDUK technology and performance standards favour capacity over coverage

The BDUK NGA programme has set a standard for internet connectivity speeds.

Fibre technology is assumed to be the only technology that can deliver the speeds required. But there is now a growing assumption that it is the only eligible technology for any new broadband connection.

Fixed wireless is a simple and effective solution for rural broadband. And it's easy to deploy rapidly. There are many community-base initiatives and organisations, and service providers, who use wireless as a practical means of providing broadband, with speeds of 10Mb/s or more, to many rural subscribers. These networks, until recently, had the benefit of grant funding, through bodies such as DEFRA's the Rural Communities Broadband Fund, or the Rural Development Agencies, now Local Enterprise Partnerships.

Alternatives sources of support for the last 10% are disappearing. It's BDUK or nothing

There is evidence that eligibility for funding from all sources is being measured against BDUK criteria for eligibility, which have appear to be becoming accepted as the de facto standard for all broadband. Simply expressed "if it doesn't match BDUK speeds, or use fibre, it's not broadband, and it's not eligible for support".

For example: applications to the Rural Communities Broadband Fund (RCBF) are now assessed against BDUK technology standards. While fixed wireless can provided connections far in excess of the 2Mb/s minimum set for the last 10%, it is apparently—and wrongly—rendered ineligible for support on engineering grounds. We are not aware of any fixed wireless provider being included in the BDUK programme, in spite of the fact that: the technology meets EU and BDUK criteria for eligibility; it is at least an effective interim solution for rural and remote communities and, at best, a powerful long-term solution.

Rural areas = slowest return on investment

In rolling-out the UK's superfast broadband infrastructure, BT will inevitably focus on those geographical parts of its network which offer the highest return for least cost. That can only mean a heavy bias towards urban areas and larger communities. Such parts of the network already have internet connection speeds far higher than those available in rural areas, who will have to wait "at the back of the queue" to see any upgrade in speed.

In consequence, non-metropolitan citizens will have to wait longer, for slower internet connections than their urban counterparts. Yet, given rural life and work styles, high personal transport costs, high rural energy costs, and the possible prospect of an end to a universal postal service, those non-metropolitan citizens can be argued to include the most needy for faster internet.

The digital divide, the gap between those with easy fast internet access and those without, appears set to grow wider, as urban users get ever-faster speeds, and longer, and rural communities wait ever-longer until BT finally have nowhere else left to upgrade.

The exclusion of fixed wireless from the BDUK strategy is wrong, on two counts.

Anecdotal and first-hand evidence suggests that there are two assumptions in the minds of BDUK.

One: wireless isn't an eligible solution.

Two: If wireless is eligible, it doesn't perform well enough.

Wireless is an eligible solution (see Appendix 1). And it does perform well enough.

Village Networks Ltd, authors of this submission, were ultimately rendered ineligible from the BDUK tendering process for Buckinghamshire and Hertfordshire "*because you don't lay fibre*". Even if that was true, which it isn't, it's not a ground for ineligibility (Appendix 1).

And in another case:

"it does look like the engineering solution may fall outside of the Superfast/NGA definitions for radio based services and you may struggle to attract RCBF".

That's a quote from a response to a small rural community's application for RCBF support. And it's wrong.

Wireless broadband can easily double existing speeds in non-broadband-connected communities. Wireless can provide up to 1Gb/s, if required. Existing wireless networks already make use of fibre components—either their own, or via access to FTTC—and it is likely they will only increase their use of fibre as the superfast broadband initiative increases the availability of fibre.

There is no reason to exclude wireless broadband from BDUK's programme. There is every reason to deploy fixed wireless as an adjunct to FTTC and FTTH in the harder-to-reach areas, either as an interim measure, or as a developable long-term solution. The strategy would speed the roll-out of broadband across the country as a whole. It would provide the last 10% with connections well in excess of 2Mb/s, should they want them, and it would provide those connections much sooner.

CONCLUSION

The BDUK fixation with capacity rather than coverage is misguided. The application of support should place an at least equal priority on rural areas who, broadly described, have nothing, in contrast to the urban and metropolitan population who already have plenty.

The deprived rural communities are, by BDUK's definition, the last 10%. They are a small minority. When evaluating best-value for the use of grant funding for broadband, the business case easily justifies a much greater than present emphasis on the rural sector.

APPENDIX I

BDUK NGA TECHNOLOGY GUIDELINES

Please note: This document may be subject to change if feedback is received from stakeholders. The latest version of this document will be held on the BDUK web-site.

Please Note: This document is made available by BDUK to local bodies for guidance in respect of local broadband projects. It is not to be used for any other purpose.

This document may contain certain high level and/or selected summary information only and care should be taken if relying on its content. To ensure they are fully informed, local bodies should refer to the relevant more detailed documentation (where available) and otherwise consult with BDUK and/or their own professional advisers.

Anybody using this document must seek their own legal advice in respect of its content. DCMS (including BDUK) accepts no liability for: (i) the accuracy of this document; or (ii) its use in respect of a local broadband project or otherwise.

Broadband Delivery UK (BDUK)

National Broadband Scheme for the UK

Guidance: The role of Next Generation Access technologies in addressing superfast broadband market failure under the UK's State aid scheme

1. Introduction

1.1 Local broadband and community projects that are part of BDUK's superfast broadband programme will be subsidised to varying degrees by funding from DCMS, as well as other UK and potentially EU public sources. In almost all cases the funding for these local broadband projects will give rise to State aid.

1.2 This document provides guidance to local and community bodies as well as other interested stakeholders on the role that we expect fibre, wired and fixed wireless technologies to play in achieving the superfast objectives within BDUK's broadband programme. The requirements that we have set out here are central in promoting the supply of advanced broadband services to residential and business consumers.

1.3 It is essential that State aid measures that are designed to address identified market failures in the provision of NGA, do so in a coherent and effective manner. The outcome of the proposed broadband intervention should deliver better broadband speeds and enhanced coverage. In most instances, this means an NGA Network infrastructure is deployed in defined "white" intervention areas by a supplier and this capability provides the means to deliver superfast broadband services to end users. All NGA technologies, including fibre, wired and fixed wireless technologies each may have a role in delivering those outcomes.

1.4 To be able to use State aid under the UK's scheme, local bodies are required to run open procurement processes that are technology neutral. They must not "pick technologies", but rather select suppliers on the basis of the most economically advantageous tender (MEAT). A local body's tender process would award MEAT by defining criteria that express the project's objectives and assessing solutions for the value they provide against these criteria. A local body's criteria may include:

- the speed and coverage offered by a solution;
- the quality of a solution;
- the scalability and upgradability potential of the solution;
- the level of open access¹ and the retail offering;
- the deliverability of the solution;
- the commercial sustainability of the solution; and
- the cost² and financial risk associated with the deployment of the solution.

1.5 However, bidders are constrained in that they are only able to receive State aid in respect of technologies that are classed as NGA technologies where targeting white NGA areas that are not also basic white areas. The text of the Commission's decision³ requires NGA technologies in receipt of public funds to provide a step-change in capability. This document provides more detail on how BDUK's National Competency Centre (NCC) would interpret these requirements for a given technology.

1.6 The guidance provided here should be read in conjunction with other detailed guidance dealing with the complementary elements to the requirements including the access conditions that apply to part-state funded networks. In particular, reference should be made to (i) the general and specific wholesale network access requirements that will apply to suppliers in direct and indirect receipt of State aid;⁴ (ii) the general condition applying to the supplier in instances where, a third party makes a new request for wholesale network access;⁵ and (iii) the pricing rules that constrain the supply of specified active and passive access products.⁶

1.7 The Commission's decision notes that only certain advanced Fixed Wireless Access (FWA) technologies can currently qualify as an NGA Network.⁷ This document also sets out requirements in respect of subsidising FWA as an NGA network, and aims to clarify the specific conditions on FWA in paragraphs (42) and (74) of the Commission's decision.

1.8 In regard to FWA, this document assumes that that both the serving network nodes (eg base stations) and customer premises equipment are deployed in permanent or semi-permanent locations, and this excludes

¹ This is required for State aid compliance under paragraph (49) of the Commission's decision regarding the UK's scheme

² This is required for State aid compliance under paragraph (49) of the Commission's decision regarding the UK's scheme

³ European Commission, State aid SA.33671 (2012/N), National Broadband scheme for Broadband Delivery UK, 20.11.2012, at http://ec.europa.eu/competition/state_aid/cases/243212/243212_1387832_172_1.pdf

⁴ BDUK, Guidance on wholesale access conditions applicable to part-state funded networks, at: http://www.culture.gov.uk/images/publications/BDUK_Draft_wholesale_access_conditions_050912.pdf

⁵ BDUK, Basic test for new wholesale access requests on part-state funded networks, at: http://www.culture.gov.uk/images/publications/State_Aid_Guidance_for_new_wholesale_access_requests.pdf

⁶ BDUK, Guidance on benchmarking and other access pricing, at: http://www.culture.gov.uk/images/publications/State_aid_Guidance_Benchmarking.pdf

⁷ See paragraph 57 of the EU Guidelines for the application of state aid rules in relation to the rapid deployment of broadband networks, see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:025:0001:0026:EN:PDF>

personal mobile devices (and dongles). Qualifying a mobile network technology as NGA is currently outside the scope of this document. If necessary, direct advice should be sought from BDUK on mobile networks.

1.9 In assessing projects for State aid approval, the NCC will require that projects submitted to it for use in NGA white areas meet the requirements below. For example, the requirements are consistent with the approach taken by BDUK to assure suppliers' solution components offered as part of their bids for BDUK's Broadband Delivery Framework, and approved by the NCC for projects calling off the framework.

1.10 The approach that BDUK has set out in this guidance has been developed in light of feedback from the European Commission. These requirements are deemed necessary to meet State aid requirements under EU law. They have been explicitly designed to meet those State aid requirements and are legally separate to the requirements specified under the UK/EU regulatory framework for communications.

1.11 Local Bodies should also utilise the principles set out in this guidance when assessing a response to either an Open Market Review and/or a Public Consultation when making decisions on whether to classify claimed coverage as NGA provision within its coverage maps.

2. Requirement 1: *The subsidised solution must deliver a "step change" in network capability and service availability and consistently provide a high quality experience to end users*

2.1 This requirement ensures that where a basic broadband infrastructure already exists, State aid must only be used to deploy infrastructure that genuinely offers a significant new capability to end users.

2.2 In assessing projects for State aid approval, the NCC requires that NGA technologies that are used in NGA white intervention areas must provide the same outputs as those defined for other established NGA network deployments. Specifically, the NCC will expect to see that the technical solution:

- is capable of providing access speeds in excess of 30Mbps download, not only by reference to theory and technical standards, but also by evidence of calibrated performance measurements of an existing deployment within the area of interest or an demonstrably equivalent deployment in a similar geographical environment;
- typically provides at least a doubling of average access speeds in the target NGA intervention area;
- must be designed in anticipation of providing at least ~15Mbps download speed to end-users for 90% of the time during peak times in the target intervention area, as demonstrated by industry-standardised or reliable independent measurements;
- must show how the solution would adapt to maintain capability and end-user experience in changes to key parameters such as increased take-up and increased demand for capacity, and be able to show using clear calculations that this is both technically and commercially viable;
- must have characteristics (eg latency, jitter) that enable advanced services to be delivered eg video-conferencing and High Definition video streaming to be provided to end users as evidenced by trials results not necessary obtained within the area of interest; and
- have longevity such that one might reasonably expect increases in performance within the next seven years.

2.3 In assessing whether the requirement is being met, the NCC will require the applicant to provide evidence of the capabilities detailed above. That evidence might include:

- The Business case, including scenario analysis;
- Planning consents having being obtained, or likely to be obtained, for the proposed developments;
- Actual deployment of similar scale and end-user density;
- Field trial or commercial deployment supplemented by modelling of different take-up scenarios;
- For wired NGA technologies: access network planning taking due account of wired line length and quality from existing or planned access nodes, to show that the access speeds are realistic in the geographic context;
- For fixed wireless NGA technologies: radio plans and interference analysis, using planning tools correctly calibrated for the target geography, to show that the access speeds are realistic and the spectrum to be used is appropriate for its geographic context;
- Proposed product offerings and associated service level guarantees;
- Network dimensioning calculations; and/or
- Evidence that the enabling technology has a future development path, such as existing internationally accredited standards, on-going development of new versions of the standards, international research working groups, and diversity of the supply chain.

3. Requirement 2: *Where a subsidised access solution using alternative technology such as fixed wireless access (FWA) is used, there shall be a commitment to upgrade to fibre components at a later stage*

3.1 This requirement ensures that public money is used to support infrastructures that offer the most viable route to full fibre infrastructure; where that goal is not economically viable today, any subsidised solution should support this goal eventually (ie when revenues increase or deployment costs decrease sufficiently).

3.2 In assessing projects for State aid approval, the NCC will expect to see that the solution is able to meet the following criteria:

- The supplier must demonstrate how its solution design has—to the extent economically viable—incorporated the deployment of long-term infrastructure that permanently reduces the barrier to further network deployment in that area;
- The supplier must provide a commitment to transition to higher-performance fibre solutions when network economics justify that change. Examples of how this requirement could be met include:
 - providing future plans, and the necessary economic conditions to initiate them, for upgrading parts of a network where it is not economic to upgrade the whole network, provided that the future upgrade potential of other parts of the network is not limited by doing this; for example, by extending fibre from backhaul elements to some or all of the local distribution nodes; and/or
 - offering customers an option to receive performance-enhancing fibre upgrades when requested, where any direct implementation and operating costs can be recovered from customers, either upon installation, or through a reasonable financing arrangement which disadvantages neither the customer nor the supplier.

3.3 In assessing whether the requirement is being met, the NCC will require the applicant to provide evidence that would demonstrate the commitment detailed above. That evidence might include:

- the supplier's business case showing the comparative investment case for deploying non-fibre components instead of fibre components, including economic justification for use of each non-fibre network component (eg copper loops, microwave backhaul, point-to-multipoint wireless access);
- the supplier's deployment plans for passive infrastructure (eg new ducts and mast sites);
- a contractual commitment to upgrade to a wholly or partly fibre network, based on appropriate triggers (eg access network capacity, level of take-up); and/or
- a developed product description and indicative pricing for a performance-enhancing fibre-upgrade customer option.

April 2013

APPENDIX II

The Commission's Decision on Case SA.33671 BDUK:

In low population density areas, where for instance existing fixed networks due to the long line length are only able to provide low speeds (ie speeds typical for basic broadband services), alternative technologies, such as certain fixed wireless networks⁸ could also ensure a step change in terms of broadband availability. Such alternative technology could also be eligible for state aid provided that i) the average speeds are at least doubled compared to the existing speeds; ii) it is able to provide reliably at least 30 Mbps speeds in the target areas and iii) there is a commitment to upgrade to fibre components when economically viable.

Written evidence from UK Broadband

INTRODUCTION

- UK Broadband is a provider of both mobile and fixed wireless broadband services. In particular we can provide fixed wireless networks that can guarantee to deliver Next Generation Access (NGA) speeds. UK Broadband has demonstrated its fixed wireless NGA network capability to the European Commission. These networks are eligible for state aid and can play a useful part in helping to provide NGA to 99% of the UK.

⁸ Since the wireless medium is shared between subscribers and is inherently subject to fluctuating environmental conditions, in order to provide reliably the minimum speeds per subscriber that can be expected of an NGA, fixed wireless networks may need to be deployed at a certain degree of density and/or with advanced configurations (such as directed and/or multiple antennas).

- UK Broadband was the fixed wireless partner of a number of large fibre providers at the start of the BDUK programme when the BDUK requirement was for bidders to cover 100% of each bid region. We planned combined fibre and fixed wireless solutions that delivered NGA to 100% of each bid region for more than 30% of the bid regions. Unfortunately, one by one, our fibre partners withdrew from the BDUK process as the BDUK Framework became increasingly onerous and more favourable to the incumbent.
- Our parent company, PCCW (which owns Hong Kong Telecom), made substantial capital available in 2011 to invest in BDUK projects provided a business case could be made. However, to date, we have not been able to spend any of the capital allocated meaning that this inward investment to the UK has been prevented and our intentions have been frustrated.
- UK Broadband entirely supports the Government’s vision of ensuring high speed NGA broadband to the whole of the UK. We believe this could have been achieved with the money available by 2015 if the right conditions had been created.
- The NAO’s report makes two major criticisms: that the Government has secured insufficient competition with BT; and that the project has over-run. We have been engaged with BDUK since the inception of the rural broadband programme and can comment on each allegation.

INSUFFICIENT COMPETITION WITH BT

- UK Broadband believes that, for some 50% to 60% of the country targeted by the rural broadband programme, BT is probably the only viable supplier whatever system of procurement had been used. It is the lack of competition in the remaining 40% that is of concern.
- Currently there is no competition with BT on the BDUK Framework and no possibility of there being any. The BDUK scheme approval from Brussels is an “Umbrella Approval”. Within the Umbrella there is a Framework Agreement under which the so called “90% areas” will be undertaken. Only BT is actively participating in the Framework. The only other party approved by BDUK to be on the Framework, Fujitsu, withdrew its interest even before the Framework commenced.
- The development of the Framework structure by BDUK was slow—taking more than 12 months—and the eventual Framework and deployment bars were set so that effectively only BT could comply with it. The bars could have been set differently, particularly in terms of actual NGA coverage requirement, timescales, technology neutrality and a requirement to demonstrate maximum value for the state aid deployed.
- BDUK has allowed Fibre to the Cabinet (FTTC) to be an approved NGA technology despite its technical limitations that means it will not deliver NGA to all households connected to it. BT is uniquely placed to deliver FTTC whereas other providers are not. Other providers would use a mix of technologies including Fixed Wireless.
- Further, BDUK accepted reducing each bid region coverage to only the so called “90% area”. By reducing the minimum coverage requirement for each bid region to around 90%, by accepting that FTTC would qualify as NGA for all premises served (despite its technical limitations) and by not introducing a maximum value-for-money measure, BDUK made the Framework more favourable to the incumbent.
- During the crucial period of the development of the Framework Agreement, and for many months thereafter, BDUK did not do enough to make clear to both bidders and the procuring authorities that Fixed Wireless could be used to deliver NGA. Still today the BDUK guidelines are not clear enough. It took six months from the publishing of the revised EU State Aid Broadband Guidelines in January 2013 for BDUK to write to the European Commission to request that the UK Umbrella Approval is brought in line with the new guidelines by removing all remaining discrimination against fixed wireless networks. Further, it is our view that BDUK guidance discriminated against fixed wireless, requiring providers to meet technical standards not required of other technologies.
- It is now too late to introduce competition directly into the 90% bid regions covered by the Framework. However it is now intended that BDUK delivers the so called remaining “final 10% areas”. If these are procured under the existing Framework, then only BT can win them. If, however they are delivered under the wider Umbrella agreement, more competition could be attracted. A new level playing field would, however, have to be established to attract more competitors.

PROJECT OVER-RUN

- BDUK was far too slow in creating the scheme for approval by the European Commission. More than 12 months was lost. They were criticised by the Commission for not engaging with them sufficiently to ensure an earlier approval.
- By effectively having only one bidder, BDUK have handed BT the enormous task of building the whole of the 90% areas. If there were more than one participating company, the schemes would be completed more quickly.

- There is a lack of effective penalties on BT for under delivery on time scales. The design of the scheme that led to there being only one bidder has created this bottleneck.

NEXT STEPS FOR IMPROVEMENT

- Whilst the Framework has already determined the future of the 90%, there is still the very important 10% to consider and solve quickly. What is required is a genuine level playing field. We would welcome the chance to discuss these issues with the committee, and would like to see ministers and officials offered the chance to lay out their plans for ensuring full technology neutrality as a means to securing best value from here on.

To improve speed of delivery in the 10% areas the following need to happen:

- BT must be required to define now the “10% areas”.
- Time penalties should be imposed on BT within the 90% bid regions which, if not met, should allow another provider to step in and replace BT in the areas not yet serviced.
- It is vital to ensure that any company that has invested in a network that delivers NGA today, or has been awarded a contract to do so, cannot be competed against in that area by BT or any other provider with the use of public funds.
- BDUK must do more to acknowledge fixed wireless as an NGA solution and one endorsed for use in the UK by the EU.

Questions we would like to see ministers answer:

- Why did BDUK not write to the European Commission in January this year to ask that they remove the discrimination against Fixed Wireless in the UK Umbrella approval as it was invited to do by the Commission? Can Ministers confirm that a letter has now been sent?
- Can Ministers confirm that they will force BT to define the 10% areas within the next 30 days?
- Can Ministers confirm that any company that has invested in a network that delivers NGA today, or has been awarded a contract to do so, cannot be competed against in that area by BT or any other provider with the use of public funds?
- What steps are you taking to make sure local authorities consider a mix of technologies and providers?

Nicholas James
CEO

15 July 2013

Written evidence from the Independent Networks Cooperative Association (INCA)

1. THE FAILURE OF COMPETITION

1.1 Competition in the BDUK programme failed for four principle reasons:

- 1.1.1 The gap-funding model based on the monopoly incumbent’s “gap” automatically favoured BT. Lack of access on acceptable commercial terms to BT’s existing passive infrastructure (ducts and poles) to reduce costs was a significant barrier to entry. BT was pushed to introduce a Passive Infrastructure Access product but the terms were too restrictive for alternative providers to be able to use it.
- 1.1.2 Demand risks were perceived as high.
 - 1.1.2.1 There were no “anchor tenancy” arrangements promoted in the BDUK process—eg contracts to supply public sector organisations to create stable demand. Indeed the Public Sector Networks procurement was kept entirely separate from the BDUK rural roll out.
 - 1.1.2.2 The big third party Internet Service Providers that could aggregate consumer demand for services would not engage unless an alternative provider could demonstrate sufficient scale—1 million homes passed was quoted. This was because there was no alternative wholesale platform linking alternative networks to service providers, despite INCA, the Broadband Stakeholder Group (a government/industry supported body) and other organisations identifying this as a substantial barrier early in the process.
- 1.1.3 Smaller players were excluded from bidding process from the outset, despite the fact that a number are building future-proofed fibre and high-speed wireless networks in rural areas today. They were excluded because they were not perceived to have sufficient “scale”. Consortia were encouraged but the preferred model involved the prime contractor (lead partner) taking a disproportionate share of the business risk in the process.

1.2 It would have been better to encourage different forms of consortia involving new asset-holding vehicles allowing different consortium members to participate according to their own business plans and appetite for risk. Smaller players could have been engaged and if coupled with encouragement for a greater variety of

funding models other than simply providing grants, genuine competition to BT would have emerged. The European Commission recognises five different models of public intervention in next generation broadband.

1.3 INCA presented this analysis to DCMS officials in October 2012 and to the Secretary of State in January 2013. The Secretary of State agreed that INCA should make a proposal designed to encourage competition. Officials rejected the subsequent proposal.

1.4 The consequences of the failure of competition are that local authorities have no choice in the procurement. When coupled with the lack of transparency over BT's costs it is difficult to see how the public sector can genuinely demonstrate value for money in the process.

1.5 A second consequence is a failure to encourage competitors, innovation and additional investment. Countries like Sweden with vast rural areas have a variety of providers delivering fully future-proofed fibre to the home (FTTH) services in deeply rural villages at a state aid intensity of typically 25–33%. One INCA member alone (Rala) was involved in 90 such projects in 2012. UK local authorities have a choice of just BT offering private sector investment of 23% (state aid of 77% rising to 89% or higher in the Final 10% areas). At the House of Lords inquiry into rural broadband last year BT said they would commit £1 billion to this process. The NAO says BT is committing £356 million. A range of industry players, large and small were prepared to offer very high quality solutions coupled with additional private sector investment. Almost all are currently sitting on the sidelines.

2. TRANSPARENCY

2.1 BT's costs lack transparency as the NAO has pointed out very eloquently.

2.2 Their roll-out plans lack transparency too. As part of the contract with local authorities BT provides a "Speed and Coverage Template" identifying the broad roll out plan, including areas designated "no build". These areas along with those that will receive fibre to the cabinet (therefore designated NGA) but with premises too far from the cabinet to gain any speed benefit, constitute the Final 10%. BT has designated the speed and coverage template as commercially confidential. Without this information it is impossible for communities and alternative providers to identify the areas where BT will not be delivering superfast broadband, so that they can take action for themselves. Freedom of information requests to a variety of local authorities have all come back negative—the information in the Speed and Coverage Template is regarded as commercially confidential. We cannot see how it can possibly be in the public interest for the coverage plans paid for by the taxpayer to be a secret. It seems even stranger that areas not covered by the superfast broadband roll-out should also be secret, unless BT wanted to prevent the emergence of potential competitors.

2.3 BT argues that it cannot know the final roll-out plan until it has done detailed investigation of its existing networks (it doesn't know precisely where all the cabinets are, or the state of its duct infrastructure) and detailed planning has taken place. Our argument is that the information contained in the SCT is sufficiently detailed for communities and alternative private sector companies to make their own decisions and plans about investment, particularly in the Final 10%. At least one local authority, Northamptonshire, has bitten the bullet and published very useful coverage maps based on its contract with BT and is now seeking engagement with other industry players to provide Final 10% coverage.

2.4 We are now receiving information that some local authorities claim they do not have such information. If this is the case they have apparently signed contracts with BT without any control over the coverage areas.

2.5 The contracts that local authorities have signed include sweeping non-disclosure agreements effectively preventing local authority officers from raising concerns publicly or discussing their contractual arrangements with other local authorities.

3. OVERBUILDING

3.1 State aid is designed to address areas of market failure. It should not be used to stop private investment and restrict competition.

3.2 INCA has a growing number of examples of community and private sector businesses offering fibre to the home (FTTH—fully future-proofed) and high speed wireless services (designated NGA in the new state aid guidelines) being deliberately targeted for overbuilding by BT using state funds. These are companies and community projects that require far lower levels of state aid than BT (in some cases zero state aid). Hence there is a danger that state aid is being used to crowd out private sector investment.

3.3 BDUK's response has been that only those private sector projects notified at the time of the "Open Market Review" in 2012 need to be taken account of. Given that the timescale on the main programme has slipped to 2017 and beyond it seems bizarre that only plans developed fully five years earlier should count. BT's plans will certainly change substantially in that time.

3.4 In the meeting with Maria Miller on 15th July these issues were raised and she expressed her desire to encourage competition. As a result INCA has been approached by BDUK officials to help find a resolution that can satisfy the various parties.

4. RURAL COMMUNITY BROADBAND FUND

4.1 The RCBF was created by DEFRA from RDPE funds. It is a small £20 million fund administered by BDUK designed to support experimental projects delivering superfast broadband in the final 10%.

4.2 Two types of project emerged—most led by local authorities that will effectively bolster their main BDUK funding, a minority led by communities themselves.

4.3 The process has been tortuous and very few projects have been contracted. Six community schemes from the original funding round remain with applications outstanding but not finalised. This was the principal reason for the meeting with the Secretary of State on 15th July.

4.4 When they applied the projects had to demonstrate that they had reasonable certainty they were in the Final 10%. This changed early in 2013 when a new definition was applied—they had to be in the Final 10% as designated in the Speed and Coverage Templates that are currently secret. BDUK advice to local authorities has been that they first contract with BT for the main programme, then ask for a change control to the contract and pay BT to do an impact assessment on whether the scheme should be accepted. In the meeting with Maria Miller BT did not want to budge on simply allowing the projects through. However the secretary of state is determined that these projects should go ahead and has tasked Jon Zeff with making it happen.

4.5 The six remaining community RCBF projects cover about 60,000 homes, have detailed and credible business plans, have invested their own money (community and private investment), are aiming to provide 100% coverage with FTTH, and have a state aid intensity of between 25% and 40%.

5. ECONOMIC DEVELOPMENT

5.1 From a local authority and central government point of view encouraging the development of superfast broadband services is an economic and public service imperative. From a telecoms operator's point of view it is about providing a new range of consumer services, mainly based on TV-style offerings.

5.2 It will be a surprise to PAC members that BDUK have commissioned research indicating that the roll-out of superfast broadband by postcode declines as the percentage of businesses in a postcode rises. Two reasons can be surmised:

- BT does not have suitable network for upgrade near to business parks.
- BT prefers to try to sell expensive “leased lines” (business grade connections) to businesses and it does not want these services cannibalised by low-cost “superfast” services.

5.3 We are paying for a network that apparently is not being pushed towards businesses when the country is crying out for economic growth.

6. RECOMMENDATIONS

6.1 *Transparency*

6.1.1 We need to have full transparency over BT's costs. As the NAO report pointed out BT scored only 7 (later raised to 8) out of 20 on their cost transparency. Independent experts like Mike Kiely are raising important concerns about the potential for BT to “pad” their costs.

6.1.2 We also need transparency over roll-out plans. Sean Williams offered to release the Speed and Coverage Templates that form part of the local authority contract. A recommendation from PAC that BDUK and local authorities publish the data would be very helpful in identifying the Final 10%.

6.1.3 Transparency over speed. With a deployment based on FTTC, premises more than 1.5km from a cabinet will gain no speed benefit but will still be treated as being covered by Next Generation Access even though they will not get superfast broadband (24mbs downstream). BT should be required to identify the number of premises this affects enabling local authorities to develop plans to address these premises in addition to the Final 10% which have no plans for coverage.

6.2 **No Overbuilding**—if a private sector company or local community is prepared to invest in FTTH or high speed wireless services they should not face the risk of being overbuilt by BT using state funds. BT should not be allowed to use its power to stifle competition and innovation.

6.3 **Fully Open Access**—BT has resisted opening up its network at the fibre and duct level. The state is effectively gifting BT £1.2 billion to remediate its rural network. This funding should be used to facilitate competition down to the passive layers, not to allow BT to construct a huge moat around its monopoly. This means revisiting the Passive Infrastructure Access proposals and getting serious action from Ofcom on infrastructure competition.

6.4 **Encourage Different Models for Public Investment**—The European Commission recognises five models for public investment in broadband published in the *Guide to Broadband Investment*. The UK has focused on just one approach—gap funding, citing it as being the lowest risk for the taxpayer. As we have seen it also has the potential for shutting out the competition, reducing the level of potential investment, reducing innovation and creating serious concerns about value for money. Local authorities should be

encouraged to consider a wider range of funding models that can encourage competition, greater investment and innovation in the delivery of new next generation access networks.

ABOUT INCA

The Independent Networks Co-operative Association brings together over 500 organisations working to develop next generation broadband networks in the private, public and community sectors.

INCA'S MISSION

The members of the Independent Networks Cooperative Association (INCA) are supporting, planning, building and operating sustainable, independent and interconnected networks that advance the economic and social development of the communities they serve and permit the provision of applications and services through open competition, innovation and diversity. They are working together to create cohesive interconnected next generation networks.

INCA's role is to:

- Promote the development and adoption of common technical & business standards amongst local projects.
- Underpin the development of next generation networks by developing joint purchasing and marketing approaches.
- Act as a unified voice for local projects to government and industry.
- Promote the sector and explain why next generation broadband is important.
- Support the development of next generation broadband projects by sharing expertise and information.
- Work with other agencies to promote and support local project opportunities.
- Encourage partnerships with public, private and community sector organisations to facilitate investment and faster roll out of next generation broadband infrastructure, particularly in under-served areas of the country.

Malcolm Corbett
Chief Executive

25 July 2013

Supplementary written evidence from UK Broadband

Thank you for the opportunity to give evidence to the Public Accounts Committee hearing on 17th July. I am writing to provide further information and clarification with respect to some of the points I made at the committee and in response to some of the remarks made by both BT and BDUK officials. I hope the Committee will find this useful.

THE BASIC PRINCIPLES OF THE BDUK RURAL PROGRAMME

On 15 July 2010 the Department of Business Innovation and Skills (BIS) held an Industry Day to launch its Broadband UK (BDUK) initiative and to attract organisations and companies that wanted to participate. The day involved speeches and/or presentations from Jeremy Hunt, the Secretary of State for Culture, Olympics, Media and Sport, Caroline Spelman, the Secretary of State for the Environment, Food and Rural Affairs, Ed Vaisey, the Minister for Culture, Creative Industries and Communications, Adrian Kamellard, the Director of the newly formed BDUK and other Government Officials.

At the Industry Day BDUK officials explained how the national scheme would work. They explained that their aspiration was to get broadband "to virtually all of the UK". Also that getting broadband to "all of the UK will need a range of technologies". It would be up to the supplier "to balance lower cost to government versus greatest penetration of superfast broadband". Superfast broadband is also referred to as Next Generation Access (NGA) as it is on the basis that NGA is delivered to homes and businesses that state aid can then be applied.

The key take-aways from the Industry Day were:

- (1) Government was committed to having as many parties bidding as possible.
- (2) To mitigate delivery risk, smaller players should join consortia.
- (3) A mix of technologies and solutions would be required.
- (4) Only a consortia approach could deliver the mix of technologies required to maximise the coverage areas for the money available. (This included the assumption that BT would subcontract others where BT did not have the technology in-house such as Fixed Wireless).

- (5) Bidders would need to show how their solution maximised the number of households that received NGA for the money available.

The actual outcome three years later is that not one of the policy objectives set out at the Industry Day have been met. Even with only one supplier, namely BT, BDUK could still have achieved objectives 3, 4 and 5 if it had been able to adhere to its policy objectives in its negotiations with BT.

It was also indicated in 2010 that the public sector would be encouraged to make its own networks available to bidders. However, this was not to become part of the eventual procurement framework, and the lack of such “anchor tenants” was another of the factors that led to the withdrawal of some of the bidders, particularly when the bid areas remained too many and too small.

MIXED TECHNOLOGIES AND MAXIMISING HOUSEHOLDS COVERED FOR THE BUDGET AVAILABLE

Using a mix of technologies is the key to maximising the households covered. Using a combination of fibre and Fixed Wireless technologies together in a bid area is the only way today to maximise coverage for the money available. Deploying fibre to a *fixed wireless cabinet/base station* provides NGA to homes up to 7kms from that cabinet/base station. Deploying fibre to a standard *BT green cabinet* (FTTC) provides NGA to households up to 0.9kms from that cabinet. Many households in rural areas are situated more than 0.9kms from a BT green cabinet but within the 7kms that can be served from a wireless cabinet/base station. Delivering NGA to all homes is the aim of BDUK and the reason behind the scheme as a whole. Hence why a mix of technologies is the only way that households receiving NGA in a bid area can be maximised.

By not requiring BT to use a mix of fibre and fixed wireless technologies, and instead allowing FTTC to be an approved solution, there is now no attempt to require BT to reach the maximum number of homes with NGA for the money available. Additionally, smaller players who could have subcontracted to BT to deliver fixed wireless and local fibre to the home (FTTH) solutions, so as to extend the value for money in any bid area, have been excluded. Finally, deploying fixed wireless is much quicker than deploying fibre. Thus a mixed technology solution would deliver both better overall coverage results in bid areas and faster roll out to homes.

Industry estimates of the result of allowing BT to use a single technology solution vary. As a minimum, UK Broadband estimates that at least 20% less households will receive actual (NGA) broadband than would have been possible for the same budget if a mix of technologies had been deployed. This is made up of some 10% or more households in the so called 90% bid areas where they are too far from an FTTC cabinet to obtain NGA. The remaining 10% is in the so called “final 10%” areas that will not even be considered seriously until 2017 or later. In a majority of the bid areas UK Broadband believes that using a mix of technologies at the start would have allowed up to 100% of households to receive NGA for the same or less than the cost now being spent on achieving possibly 80%.

In support of the argument that many homes in the “90%” areas will still be without NGA after BT has completed its BDUK funded work, please see attached a very recent survey and report on the post BDUK outcome in the village of Ewhurst.

In summary, the conclusion for Ewhurst is that an estimated 226 households are at such a distance from an FTTC cabinet that they will not be able to access NGA. This total of 226 equates to approximately 24% of premises (942) in Ewhurst meaning that only 56% of the total 100% BDUK bid area (the initial 90% plus the remaining 10%) will have NGA by 2017.

Of the 226 households, it is estimated there are 69 premises, including a number with multiple occupancies, where BT’s FTTC infrastructure is incapable of providing any broadband service at all despite being connected to a new fibre connected FTTC cabinet, probably due to cable quality and length.

UK Broadband believes that, if a mixed technology combination of fibre and fixed wireless had been deployed in Ewhurst, virtually all premises would have received NGA. The problem now is that it is uneconomic for fixed wireless to be deployed as an unsubsidised standalone solution for the properties that either have no broadband or less than NGA speeds as the problem areas are now separate isolated pockets, each requiring its own solution, rather than all of them being accommodated in a planned general mixed deployment aimed at maximising resources.

At a recent community meeting in the nearby village of Goudhurst, when challenged on FTTC and properties further than 1km from an FTTC cabinet, BT said that it won’t upgrade these properties without further government subsidy. When asked how long it would take for these properties to get NGA without subsidy the BT representative said “A very, very, very long time ... perhaps never”.

In summary a clear definition of those who are not going to be upgraded to NGA in the current round of BDUK funding are:

- (1) Properties that are served by cabinets that are NOT in BT’s plans ie the so called “final 10%”.
- (2) Properties that are served by FTTC cabinets that are in BT’s so called “90%” plans but that are more than 0.9km from a cabinet. This is at least 10% of a bid area and, in the case of Ewhurst, 24%.

So, BDUK is likely to deliver NGA to up to 80% of homes and possibly a much smaller percentage by 2017 for the first round of funding available. In contrast a mixed technology solution would have delivered NGA to more homes, more quickly and thus have been a better use of public funds. This outcome is not due to lack of competition. BDUK could have made the use of mixed technologies to maximise homes receiving NGAs a condition of any bid by BT. Unfortunately they were probably powerless to do so against the will of the BT monopoly and the political pressure to at least get something done. The public is the loser in both financial value for money terms and in terms of homes receiving NGA.

BT v CONSORTIUM

It was clear from the outset that BT was reluctant to sub-contract with others to deliver a mix of technologies. This was not a secret to either BDUK or potential sub-contractors. Additionally BT was starting out with a very big advantage as the monopoly provider in most of the rural areas.

If BDUK was therefore to have competitors to BT it would have to actively encourage and support the formation of consortia led by “lead contractor” major companies whose speciality was fibre. In the early stages of the BDUK scheme some six companies emerged as credible lead contractor entities. The two largest of these was Fujitsu and Thales, both major international infrastructure players quite capable of forming and managing mixed technology consortia.

To make BDUK viable for the six companies interested in being lead contractors, three conditions were key:

- (1) BDUK insisted on the “gap-funded model”. For this model to work for anyone other than BT the bid areas needed to be large enough and made up of the right mix of semi rural, rural and very rural to be viable on a standalone basis. At least 25% of the UK had the right mix if the number of bid areas had been reduced by half by combining bid areas to create larger areas.
- (2) A bid could be won by a consortia if the successful bidder was selected based on the maximum number of households receiving NGA for the money available—achieving as close to 100% as possible. (The strategic and deployment advantage of mixed technology bids really come into their own from a value for money perspective the greater the percentage of households that receive NGA in a rural area. Lower percentages receiving NGA always favour BT.)
- (3) Recognition by BDUK that Fixed Wireless could achieve NGA and could be deployed as a permanent solution in a mixed technology fibre and fixed wireless bid.

BDUK did not achieve either (1) or (3) above to retain the interest and commitment of the alternative bidders to BDUK. Once Fujitsu withdraw and only BT remained, even item (2) was then renege upon. The non achievement of these three key factors is the principle reason behind why we only have BT today and no policy of using mixed technologies to achieve maximum NGA penetration and value for money.

THE PILOT PROJECTS AND THE END OF CONSORTIA

At the 2010 Industry Day, BDUK set out their assumption that solutions would require a “supply chain with multiple components eg fixed, radio and satellite providers”. BDUK were assuming that industry would “form teams to develop complete, integrated solutions for the area”. So, with that in mind, many of those attending the Industry Day went away and formed consortia to get ready for the competitive tender. UK Broadband obtained approval from its parent company to spend up to £150 million as a fixed wireless provider within consortia.

In October 2010, four “rural market testing pilots” were announced: North Yorkshire, the Highlands and Islands of Scotland, Herefordshire and Cumbria. These areas were chosen to explore both bid and technology responses to 4 different UK areas. Only BT was in a position to undertake the Highlands and Islands. UK Broadband joined consortia that planned bids for North Yorkshire, Herefordshire and Cumbria.

The final bid for North Yorkshire submitted by the consortium would have delivered NGA to 99% of homes by 2015. Despite positive indications that this bid would be successful, our partner withdrew from the process just before contract award in 2012 because of the two major concerns of limited size of this and other bid areas and the uncertainty over the permanent use of fixed wireless under the BDUK and state aid rules. BT then won the bid with a contract to deliver only up to 90% for reportedly a similar price.

The contesting bids for North Yorkshire demonstrated three things:

- (a) that the a mixed technology approach was better value for public money as more homes would receive NGA, and
- (b) competition had forced BT to reduce its costs and pricing, and
- (c) that consortia would bid against BT if the right conditions were created by BDUK.

Herefordshire proved to be un-viable for anyone other than BT. Cumbria proved to be marginal for a consortia without being part of a larger bid area. The outcome of the pilots thus showed that at least 25% of the UK could have been viable for a consortium to win over BT should all of the other conditions have been met.

Once the consortium walked away from the winning bid for North Yorkshire in summer 2012 it became clear that BT would be the only remaining bidder on the framework (officially this occurred in March 2013 but in reality the writing was on the wall from the summer of 2012). At this point BDUK, based on the conclusions from North Yorkshire, should have forced BT to use a mix of technologies to extend its coverage and locked BT into the prices BT had used when competing with the rival consortium.

Instead, BDUK did nothing to insist on the use of mixed technologies to provide better value for money and it allowed BT's costs to creep up as the process went on. Once it became clear that there was only one bidder, BT became more confident and its costs rose. We have studied the work that Mike Kiely (a former member of BDUK) has done on examining BT's costs and we concur with his findings about steadily rising costs that have already been submitted separately to PAC.

THE COVERAGE REQUIREMENT WAS REDUCED FROM 100% TO 90%

In the recent PAC hearing both BT and BDUK suggested that it was never a requirement of BDUK to offer 100% coverage, and this is true. But suppliers were clearly told that they should aim for the maximum connectivity possible and that a range of technologies would be required to achieve this as is clearly set out in the BDUK objectives announced at the Industry Day in 2010.

When we say that BDUK "moved the goalposts" by accepting a lower requirement of up to 90% coverage, we are referring to the fact that, much later in the process at its own admission, BDUK did some modelling which showed that 90% coverage would be a reasonable achievement for a single technology solution with the funds available, as explained by Jon Zeff in his evidence to you. This BDUK modelling was based solely on a single technology solution, namely FTTC as neither UK Broadband or any other company able to deliver NGA by fixed wireless or FTTH was involved in this modelling in order to provide the data for a mixed technology model.

Focussing on a single technology solution, allowing FTTC and reducing the target from "the maximum possible up to 100%" to "up to 90%" made it possible for BT to compete on the framework. Without these two concessions BT would not have been able to succeed on the framework without mixed technology sub-contractors to help its coverage go further.

MEANING OF "90% COVERAGE"

In the recent hearing Mr Zeff stated that "the BT contracts are based on homes that have access to superfast broadband". Also "The contract specifies the number of homes that will receive particular speeds. You would not be counted as receiving a superfast speed if you are 5 km and are not able to receive a superfast speed." Such homes would be precluded, he said, from the contracted coverage in that area.

This is misleading. It is correct to say that BT is only subsidised for those homes actually receiving superfast (NGA) speeds however BT is winning contracts that cover some 90% of a bid area. Hence those households too far from an FTTC cabinet, although in a BDUK bid area, will never receive NGA without additional subsidy at a future date in time, if ever. Thus the lack of competition has allowed BT to win 90% contracts that do not deliver NGA to all of the 90% area.

BDUK'S REPRESENTATIONS TO THE EUROPEAN COMMISSION

The European Commission's 2008 guidelines for the application of state aid to broadband networks excluded services based on fixed wireless access from the definition of Next Generation Access (NGA). This was because fixed wireless technology could not deliver NGA in 2008.

By the end of 2011, the next generation of wireless equipment had been developed and delivered and UK Broadband and others were able to demonstrate that fixed wireless technologies could deliver NGA. UK Broadband explained these developments to BDUK in 2011 and urged BDUK to ensure that fixed wireless could be deployed in mixed technology NGA schemes. We were assured that BDUK understood the issue and would deal with it in Brussels.

Negotiations on the state aid approval for the BDUK scheme were going on throughout 2012. We were told that BDUK and the UK Government was fighting the corner for the use of fixed wireless and were presenting to the EU the evidence from UK Broadband that supported its use. Despite the apparent lobbying, between June and September 2012, the European Commission consulted on a revision to the state aid guidelines that included a proposal that the status quo with respect to excluding wireless networks was maintained. Again we were assured that BDUK had this matter in hand. This however proved not to be the case as in November 2012 it transpired that the Commission were as yet un-persuaded.

UK Broadband then took the matter directly in its own hands and visited the European Commission to present the evidence and to explain why we believed that fixed wireless networks utilising the latest technology were more than capable of fulfilling the requirements of Next Generation Access. The Commission was then persuaded and fixed wireless was approved in the new guidelines published in December 2012. If BDUK had employed the assistance of UK Broadband with its lobbying, the general acceptance of fixed wireless as an NGA technology would have occurred earlier.

The UK state aid approval decision was published on 20 November 2012 and technically under the old broadband guidelines that excluded fixed wireless. To attempt to compensate, BDUK extracted special concessions from the Commission to permit aid for wireless networks in certain circumstances and with certain provisos, specifically:

- Where average speeds will be at least doubled compared with existing speeds;
- 30 Mbps speeds can reliably be achieved;
- There is a commitment to “upgrade to fibre components when economically viable”.

This last requirement implied that fixed wireless was a temporary solution that had to be upgraded at some point in time to fibre to the home (fixed wireless already provides fibre to the wireless cabinet or base station). In initial discussions with potential bid areas they required that a time-scale and under-written commitment to upgrade be a condition of any bid. In one case, the advisor to two bid areas said he read these provisions from BDUK to mean “deploy fixed wireless at your peril”.

In contrast, no requirement was placed by BDUK on BT to upgrade to fibre to the home from FTTC meaning that FTTC that did not deliver NGA to all homes was exempt from an upgrade commitment whereas fixed wireless that did deliver NGA to all homes—but by wireless—was obligated to commit to swapping the service to fibre. This put fixed wireless on an unequal footing to FTTC and the impression given to procuring authorities was that wireless networks should be treated with a degree of caution.

The UK state aid approval decision was published on 20 November 2012 and technically under the old broadband guidelines that excluded fixed wireless. The Commission published its revised state aid guidelines that included the approval of fixed wireless in December 2012. Hence within one month of the publishing of the UK state aid approval, fixed wireless moved from an unapproved technology to an approved technology. In January 2013 the Commission wrote to all Member States that had state aid approvals for national broadband schemes that pre-dated the revised guidelines, including the UK. It invited those member states to write to request amendment of their national decisions if they felt amendment was required or desirable in light of the changes to the guidelines. This included the ability to interpret the use of fixed wireless under the new guidelines rather than the old.

Despite this being such an important change, BDUK did not write to the Commission to request the change offered and, instead, went ahead and published its off-putting fixed wireless conditions based on the old guidelines. These out of date guidelines and special conditions remain the BDUK funding guidelines in the UK to this day!

After constant requests from UK Broadband, a letter was finally sent to the Commission by BDUK on the eve of the Public Accounts Committee hearing. To date however BDUK has not chosen to share with us the precise nature of the correspondence with the Commission on this point and the outcome (if there is to be one) remains to be seen.

It is no coincidence if our opinion that this lack of action by BDUK on behalf of fixed wireless and the ability to thus deploy a mix of technologies in BDUK schemes without onerous special conditions favours the single technology FTTC approach of BT.

6 August 2013

Written evidence from BT

SUMMARY

BT’s deployment of superfast broadband in the UK is one of the fastest and largest commercial fibre access network deployments in the world. We have committed £2.5 billion of our shareholders funds to build this network and we are on track to complete our planned roll out, to some 19 million UK premises, by spring of 2014, some 18 months ahead of our original plan. In fact BT is installing superfast broadband, on average, at a rate that passes some 2,000 premises every working hour and so in the two hours of BT’s hearing at the Public Accounts Committee (PAC) an additional 4,000 premises in the UK were able to receive superfast broadband. As a result of this commercial deployment the UK now has superfast broadband availability to 73% of UK premises according to Ofcom’s latest UK Communications report and the average speed for all UK broadband users is now second in the G8 (behind only Japan).

The BDUK programme will have a significant impact on further extending and consolidating this progress in deployment and speed, with coverage by the end of the current planned programme expected to be well ahead of the UK’s key competitors. The resulting network will provide superfast network services to the vast majority of the UK ensuring the benefits of robust retail competition and the price and service innovation that such competition has consistently delivered. It therefore has the potential to be an excellent example of public/private partnership delivering value and benefit to the entire UK economy through the provision of first class infrastructure that all citizens and business will be able to benefit from.

The requirements of State aid and EU procurement rules have meant that the process was, at times complex, but it has been robust and consistent throughout. In spite of what was said by some witnesses the process was technology neutral, open to competition from different players and with consistent targets throughout.

BT has been successful in securing these bids because throughout our commercial deployment we have optimised the costs and efficiency of the process through heavy upfront investment in R&D, systems and industrialised processes and we have applied these cost savings and efficiency into the BDUK bids. It is interesting to note that a range of external commentators at the time did not believe that BT could achieve its fibre roll out for the low costs we planned based on their experience of other countries costs, but we have. The BDUK Framework requires that all the costs in BDUK bids are consistent with BT's commercial deployment, so that BDUK gets the full benefit of BT's scale and the resultant cost efficiency from our commercial deployment experience. The prices and models BT is committed to under the Framework were defined and committed to during the Framework process when competitors, in particular Fujitsu were fully active in the procurement. These prices provide BT with a payback period on its investments of around 15 years, which is even longer than the payback on its commercial investments.

At the outset of the process, BT indicated to government that if it were successful in winning the £830 million government announced for the rural broadband programme at the comprehensive spending review in autumn 2010 (£530 million was announced at that time for the period up to 2015 and £300 million for the period 2015–17), then it would be able to contribute up to £1 billion of extra funding (on top of the £2.5 billion committed to its commercial area deployment). BT has, as a result already committed in contracts signed to date, to some £600 million of investment. This is expected to rise to over £700 million when all of the current BDUK funded contracts are signed. This rises to £800 million if Northern Ireland and Cornwall are also included. In addition there is a potential for BT's spend to further increase towards £1 billion if BT were successful in winning any of the £250 million the Government recently announced as the next tranche of funding for the BDUK process. BT spend will be increased further still by other costs to match non-BDUK public intervention schemes and further costs related to current and future capacity, systems and technology upgrades.

The whole of BT's fibre network, the commercial deployment and any network we build utilising government funds, is fully open at the wholesale level to any other service provider on equivalent terms to those available to BT Retail. As a result all of the service providers currently selling services on BT's commercial fibre network (including BSKyB and TalkTalk etc) or new operators who wish to connect, can automatically take advantage of the new funded network to offer the same services nationwide, and at the same cost. As a result the UK is on track to having the "best superfast broadband network in Europe by 2015." Although not all the county projects will be fully complete by 2015, actual coverage of the UK will be close to 90% and growing, with some counties well above this level.

BT was therefore very disappointed that the Public Accounts Committee session focused on what we consider to be the many false, misleading and unsubstantiated statements and allegations made by other witnesses. This was in spite of the clear progress in delivering superfast networks for the benefit of the UK economy, and the further strong increase in speed and coverage that BT will deliver via the BDUK programme, all of which will benefit from the scale economies and efficiencies of BT's commercial deployment. We have therefore sought in this response to correct these statements by reference to the facts and evidence relevant to each point.

COMMENTARY

These comments are referenced against the questions number Q1 etc, as presented in the transcript of the PAC hearing on 17 July 2013.

Q2 (Nicholas James)—"A number of rules changed during the course of 2011 and up to now, which in effect ruled all of us out in one way or another."

Comment 1—This statement is false: the rule changes that Mr James alleged during the hearing to have taken place, as discussed below, did not occur. The fundamental approach of BDUK to the rural broadband programme has been consistent from the outset, an open public procurement for rural broadband networks on a wholesale and technologically neutral basis, in compliance with State aid rules. There was no change in this approach during the course of 2011 nor has there been none subsequently. Certainly no evidence of any rule changes was presented by any of the witnesses present, by the Committee or by the NAO in their report.

The truth is set out in the NAO report. The NAO reaches a detailed conclusion in its report concerning the reasons why other suppliers withdrew, none of which relate to "a number of rules [having] changed." It concluded in its report⁹ that the "design of the Framework had advantages of ensuring affordability and transferring risk" and it was these affordability and risk transfers to the supplier "together with State aid conditions" that in reality "were ... factors leading potential suppliers to withdraw from the bidding process." Rather than the rules changing during the course of 2011, as alleged by Mr James, it was the very affordability and risk transfer safeguards designed to protect the public purse that led to competitors dropping out. In short, competitors were unwilling to take on the risks and offer the affordability that BT was.

⁹ on page 6 paragraph 7 of NAO Report "The rural broadband programme" 5 July 2013

Q2 (Nicholas James)—“There were several reasons. *One is that the geographical areas are too small.* You cannot build a viable business in the way that we have carved up the geographical areas. The risk is that if you only get one of the areas, you cannot amortise your start-up costs across that area. If the areas had been bigger—*twice the size or more*—you could have taken the risk of only winning one.”

Comment 2—These assertions are not supported by the facts. The facts are that BDUK contract areas are very variable in size from the smallest (for example, Newcastle with an intervention area of 8,000 premises) to the largest (for example, Scotland (excluding the Highlands and Islands) with an intervention area of 695,000 premises). If contract size were the determinant of participation, then there were plenty of large contract tenders for bidders to participate in.

BDUK set out its delivery model and its delivery principles in a document published in May 2011.¹⁰ The Framework process delivered against these principles. These principles did not change. The first delivery principle in that document was:

“Principle 1: Let Local Bodies lead on delivery:

- Develop and manage a national programme approach within which Local Bodies can develop local approaches and take responsibility for ensuring the delivery of broadband services;
- Let Devolved Administrations in Northern Ireland, Scotland and Wales manage the co-ordination of Local Bodies in their areas in accordance with individual strategies for the development of broadband infrastructure in their nations;”

It is clear that the decision on the scale of the bid was for Local Bodies to determine, in conjunction with Devolved Administrations where appropriate, in order to maximise the competitiveness and robustness of the bidding process. Indeed, a number of Local Bodies in England chose to combine their bids together to increase the scale as suggested by the witness (for example, “Great Western Broadband” in Wiltshire and South Gloucestershire, as well as “Connecting Devon & Somerset”) and the Devolved Administrations chose either to do a single bid for their region, as in Wales, or to combine into a small number of large bids, as in Scotland where there were two tenders, one for all the Highlands & Islands and one for all the rest of Scotland. As a result there was a whole range of different sized bids from counties as small as Rutland through to whole Devolved Administrations such as Wales. For a bidder to say therefore that they could have competed if “the areas had been bigger—twice the size or more” ignores these facts.

Q2 (Nicholas James)—“The second reason is that the original plan was to provide 100% NGA, as defined by the EU, to every household in a bid area.”

Comment 3—This statement is false. There was never any plan to provide 100% next generation access (NGA) and in fact there is overwhelming evidence that the programme would not achieve 100% NGA.

In September 2008, long before the BDUK programme was finalised, the Broadband Stakeholder Group produced a report¹¹ on behalf of industry and DCMS/BIS that estimated the likely cost of providing broadband across the UK. This report highlighted that the cost of a fibre to the cabinet (FTTC) solution across the UK was in the region of £6 billion in contrast to a (fibre to the premises (FTTP) solution which would cost in the region of £30 billion. To address that need, BT has committed £2.5 billion of its own funds to deploy a commercial footprint of FTTC and FTTP plus up to £1 billion of additional funding to match government funds. The Government then committed £530 million in the comprehensive spending review of autumn 2010 to augment the commercial deployment from BT and the existing Virgin Media network. At this level of government investment it was evident from the outset that there was no intent to fund 100% superfast broadband to every household in a bid area. There was never enough funding to achieve such a goal. Indeed there still isn’t, even after the recent announcement of a further £250 million in the next Parliament, to get to 95%. Indeed this has been confirmed in all subsequent government policy statements, in the objectives of the BDUK scheme (which has the objective of achieving the best superfast broadband (SFBB) network in Europe—see below), and in subsequent government policy statements which all speak of a 90% coverage objective. Indeed, the then Secretary of State, Rt. Hon Jeremy Hunt MP, wrote to all MPs in June 2011 to explain the imminent allocation of the government’s BDUK funding. In that letter he explained that allocations of funding would be made based, “on an estimate of the costs for a private sector operator to provide superfast broadband to at least 90% of premises in every local authority area and to provide fibre connectivity of 2Mb/s to every community”.

¹⁰ BDUK Programme Delivery Model version 1.0 May 2011. <https://www.gov.uk/government/publications/broadband-delivery-programme-delivery-model-may-2011>

¹¹ The costs of deploying fibre based next generation broadband infrastructure—September 2008 http://www.broadbanduk.org/wp-content/uploads/2012/08/http___www-broadbanduk6.pdf

Furthermore, the State aid clearance decision¹² corroborates the absence of any intent to achieve 100% NGA in its statement of the primary objectives of the BDUK scheme:

- “(1) to provide access to NGA infrastructure capable of delivering superfast broadband speeds to *as many homes and businesses as possible* in each local authority area in the UK; and
- (2) everyone in the remaining areas in the UK has access to minimum broadband speeds of at least *2Mb/s.*” [Emphasis added—clearly this is not superfast]

Furthermore the BDUK Delivery model¹³ referenced above set out five clear objectives of the programme as follows:

“BDUK has five primary goals:

- (i) To support economic growth in the UK, including in rural areas;
- (ii) *To ensure this country has the best Superfast Broadband in Europe by the end of this parliament (2015);*
- (iii) To ensure delivery of *Standard Broadband to virtually all communities* in the UK within the lifetime of this parliament (2015);
- (iv) To ensure the efficient use of funding to deliver Superfast Broadband and Standard Broadband; and
- (v) To assist other government initiatives which are dependent upon customers’ ability to access Broadband based services.” [Emphasis added]

It is therefore clear that the intent was to deliver “*standard broadband* to virtually all communities” and that there was never a target to deliver NGA to 100% under this programme and this certainly did not change “during the course of 2011.”

The witnesses from DCMS who appeared before the Committee confirmed this to be the case during the oral evidence Ref. Questions 187–194 in Particular Q192:

Q192 (**Jon Zeff**)—“No, the only number we then put out was that we expected, on the basis of our modelling, that our money, with match funding, would be sufficient to get to 90%. *We never said that it would get to 100%.*” [Emphasis added]

It is also confirmed by external/independent commentators such as the on-line magazine “thinkbroadband” in its article on 7th August¹⁴ (in response to Mr Barclay’s article in The Telegraph on the same issue), where they say “we do not recall any politician stating an ambition for 100% superfast broadband coverage in the UK.”

Q3 (Nicholas James)—“NGA means next generation access. If you do not deliver NGA, you are not eligible for State aid. The definition of that is 30 megabits down. There is no figure for the up speed, but we have generally thought of it in the UK as 3 megabits to 5 megabits.”

Comment 4—We agree with this definition of NGA. It is important that the Committee understand it, as it affects many other comments. The State aid clearance obtained for the UK rural broadband scheme by BDUK states clearly¹⁵ that:

“an upgrade of an ADSL network to an FTTC network with significant speed gains (capable to provide at least 30Mb/s download speeds) and significant investment is a step change and qualifies for funding.”

All of the FTTC deployments that BT has made and is planning on making as part of the BDUK programme will meet this criterion in that they will upgrade the existing ADSL service in that area and the FTTC technology is capable of providing at least 30Mb/s. In fact the Openreach FTTC service offered to UK internet service providers (ISPs) and used by BT Retail currently delivers an up to 80Mb/s service that Ofcom data¹⁶ shows currently delivers real download speeds to end users that average over 67Mb/s. This is over double the speed threshold for NGA.

The same paragraph in the State aid clearance¹⁷ obtained by BDUK also makes it clear that wireless networks would only constitute NGA if:

“(i) average speeds are at least doubled; (ii) [they are] able to provide reliably at least 30Mb/s speeds in the target are and (iii) there is a commitment to upgrade to fibre components when economically viable.”

¹² State aid SA.33671 (2012/N). United Kingdom https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198019/243212_1387832_172_1_1_.pdf—paragraph 12

¹³ BDUK programme delivery model page 5 section 3.2

¹⁴ “Is the Public Accounts Committee trying to rewrite history?” http://www.thinkbroadband.com/news/5980-is-public-accounts-committee-trying-to-rewrite-history.html?utm_source=twitterfeed&utm_medium=twitter

¹⁵ State aid SA.33671 (2012/N). United Kingdom At paragraph 42

¹⁶ Ofcom Speed report 7 August 2013

¹⁷ State aid SA.33671 (2012/N). United Kingdom paragraph 42

It is this condition in the State aid clearance for UK rural schemes that meant that any provider seeking to lower their bid costs by using a wireless solution had cause to reconsider, not any action by BT.

It is therefore correct to say that if you do not deliver NGA, you are not eligible for State aid for NGA. It is clear that BT's FTTC solution does deliver NGA and this is explicitly accepted in the State aid clearance. However, it is far from clear that a wireless solution proposed by some other bidders is capable of delivering an NGA solution. BT's FTTC solution also delivers an upstream speed of up to 20Mb/s so well above the "3Mb/s to 5Mb/s" quoted above.

Q3 (Nicholas James)—"Bid areas were reduced to between 80% and 90%. That meant that a consortium that was setting out to deliver NGA to 100% was then disadvantaged against BT, which could not deliver 100% but could deliver less than that. The more you reduce the areas, the more you favour a BT solution."

Comment 5—This assertion is false and unsupported by the evidence. As stated at comment 3, there was no objective to provide 100% NGA and the targets were not reduced. Mr James's claim takes no account of affordability as the facts are that no provider was able to achieve 100% coverage within the budget available to Local Bodies. All bidders were seeking to maximise superfast broadband coverage, but none was able to achieve 100% for the funds available. This basic constraint did not favour BT. The NAO did not find a reduction from 100% or such a reduction favouring BT over other bidders.

Q3 (Nicholas James)—"Originally, it was supposed to be NGA to every household. That has been reduced because *we have allowed State aid to fund fibre to the cabinet.*" [Emphasis added]

Comment 6—This statement is false and misleading. Fibre to the cabinet is the largest proven mass market NGA solution in the UK, and a very common approach used across Europe (eg by Deutsche Telekom in Germany, Belgacom in Belgium and many others), capable of delivering speeds of more than double the threshold required to qualify as NGA, as set out in comment 4 above, and as Mr James himself states. Among current technologies it offers the best balance of speed and coverage to meet the BDUK objectives within the funding envelope for the programme. It is also very clear that FTTC is recognised as a legitimate State aid fundable NGA solution, and is clearly stated as such in the European Commission's old and current State aid guidelines for NGA investments, both the ones that pre-date BDUK and the updated edition subsequent to BDUK.¹⁸ The BDUK Delivery programme document clearly laid out its speed objectives in May 2011. The implication of Mr James's comments—that the objectives of the scheme were reduced because FTTC was allowed to be fundable—is false and unsustainable.

In fact the threshold for NGA speeds was increased in 2011 (well in advance of the actual bid process). The BDUK Broadband delivery model increased its definition of the threshold for NGA from 20Mb/s to 24Mb/s in 2011.¹⁹

Q3 (Nicholas James)—"In reality, you may not get NGA, because if the copper that goes from the cabinet to your home goes more than about a kilometre, it cannot deliver NGA."

Comment 7—Mr James's point is not relevant because the coverage targets for NGA only count lines capable of receiving NGA speeds.

FTTC performance on very long lines will be worse than on short lines. It is therefore true that not every line connected to an FTTC cabinet delivered under this programme will be capable of delivering 24Mb/s speeds or above using current technology. The vast majority of premises (over 90%) in the UK are located within a few hundred meters of the cabinet and are thus more than capable of receiving speeds well above 30Mb/s and indeed the latest Ofcom UK fixed-line broadband performance data²⁰ shows that 92% of customers on the Openreach "up to 40Mb/s" FTTC product are receiving speeds in excess of 25Mb/s and effectively all customers on the "up to 80Mb/s" FTTC product are receiving speeds in excess of 25Mb/s.

The fact that a small minority of lines will not receive 24Mb/s is not relevant to achieving the NGA coverage targets as only those lines that do achieve 24Mb/s speeds or more count towards the NGA coverage target and so the Government's targets for delivery of NGA will be achieved using this solution. The increases in broadband speeds on long lines achieving less than 24Mb/s are an incidental benefit of the investment and will go towards achieving the second speed/coverage objective of the rural broadband programme, namely that of ensuring that all premises receive at least 2Mb/s. This is clearly identified in the speed and coverage commitments in each Local Body contract.

Q3 (Nicholas James)—"Delivering ... fibre to the cabinet in large parts of the UK ... favours the incumbent, because we would have had to come in and we do not have the cabinets in the same way; we would have had a different solution. That favoured the incumbent and put off, obviously, some of the rest of us."

Comment 8—This statement is false and misleading. The NGA State aid guidelines and the State aid clearance for the BDUK scheme have a fundamental requirement to be technology neutral. Therefore any solution that was capable of delivering NGA speeds and delivered the programme objectives of "best superfast

¹⁸ September 2010 EU NGA guidelines <http://eur-lex.europa.eu/LexUriServ/?uri=OJ:L:2010:251:0035:0048:EN:PDF> and January 2013 revised guidelines <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:025:0001:0026:EN:PDF>

¹⁹ BDUK programme delivery model version 1.01 September 2011 (Glossary page 60 new definition of Superfast)

²⁰ Ofcom UK fixed-line broadband performance, May 2013—published 7 August 2013

broadband in Europe” was eligible to compete. The fact that other bidders “would have had a different solution” was no impediment to them competing as part of the BDUK process as long as the solution they deployed met the State aid criteria and delivered on the objectives set out in the delivery programme document. Similarly they could have deployed effectively the same solution as BT through cost-orientated regulated access to all BT’s existing passive infrastructure. Openreach offer a range of Passive Infrastructure Access (PIA) products, on cost-orientated prices, controlled by regulation,²¹ that allow other operators to install fibre cabinets, connect these to the existing copper cabinet, and then to backhaul this NGA traffic from the cabinet to their network using their fibre in BT’s duct, in the same manner as BT has done, if they chose to do so. To say that an FTTC solution favours the incumbent is therefore incorrect.

Q4 (Nicholas James)—“Because, in effect, they already have the network.”

Comment 9—This statement is incorrect and misleading.

BT does not have an NGA network in the BDUK areas: that is why the BDUK scheme is proposing to invest in the building of NGA networks in rural areas.

BT has a copper broadband network in BDUK areas (which is open to other players via Local Loop Unbundling—LLU), along with the associated physical infrastructure. As stated above (in comment 8) access to all BT’s existing infrastructure is available to all bidders on cost-orientated regulated terms set and governed by Ofcom, and subject to an equivalence of inputs obligation (EOI), which means that they have to be provided to other bidders and BT itself on exactly the same terms. The fact that BT has passive infrastructure already available is therefore irrelevant to the competitive position of bidders, as the parts of the network that are useful in building an NGA network, ie the ducts to deliver fibre to the cabinet and access to the copper cabinets themselves and thus the copper wires into the premises, are all available to competing operators through BT’s PIA products which are fully approved and regulated in terms of prices terms and conditions by Ofcom. The prices for access to these assets at the time of launch were 38% below the EU average for these products.

Q5 (Mrs Hodge and Nicholas James)—“They have got the cabinet there.” “Yes.”

Comment 10—This statement is incorrect. To deliver an NGA service based on fibre to the cabinet, BT (or any other bidder) has to install *new fibre cabinets* in every case. The existing street cabinets containing copper wires are not the cabinets that can provide an NGA service. The existing cabinets with copper connections are available for all bidders to use through a cost-orientated regulated product called Sub-Loop Unbundling (SLU), which is subject to an EOI obligation.²²

Q5 (Nicholas James)—“But the whole concept was that a provider would have to show that they had maximised the available technology in the best possible way to deliver the best outcome for the money, which would have allowed alternative providers, who had alternative technology solutions, to show they had a better solution for the money available. *That measure disappeared.*”

Comment 11—The statement that such a measure disappeared is false. Two fundamental principles for the design of any State aided NGA network are reuse of existing assets and technology neutrality. In particular the EU guidelines state²³ that:

“Member States should encourage bidders to have recourse to any available existing infrastructure so as to avoid unnecessary and wasteful duplication of resources and reduce the amount of public funding.”

And²⁴ that:

“The tender should not favour or exclude any particular technology or network platform. Bidders should be entitled to propose the provision of the required broadband services using or combining whatever technology they deem is most suitable.”

To say that these measures disappeared is untrue. In fact BT’s solution has sought to re-use existing assets wherever possible and we have also sought to use a mix of technologies to deliver the NGA services, predominantly FTTC but also FTTP all of which are in accordance with the NGA definition in the guidelines. We are also testing and trialling a range of other solutions including wireless solutions, particularly as part of our solution for delivering the 2Mbit requirement. If other bidders had “a better solution for the money available” there was nothing to stop them proposing it during the bid. That is what the BDUK Framework process provides.

²¹ As required by Ofcom in the Wholesale Local Access market review in October 2010 <http://stakeholders.ofcom.org.uk/consultations/wla/statement>

²² Ofcom Wholesale Local Access Market review statement October 2012 section 1.24 <http://stakeholders.ofcom.org.uk/consultations/wla/statement>

²³ At section 3.4 paragraph 78 f

²⁴ section 3.4 paragraph 78 e)

Q5 (Nicholas James)—“My fourth point is, fixed wireless. It does worry me when you have a report that says wireless cannot deliver NGA. That is completely untrue. Fixed wireless can deliver NGA. Mobile wireless cannot. So fixed wireless can; the EU has accepted that. We have demonstrated it to the EU. There was no attempt by the UK Government to get over the fixed wireless barriers.”

Comment 12—The account of the use of fixed wireless for NGA is misleading and the statements concerning barriers to fixed wireless are false.

The clearance decision for BDUK’s rural broadband scheme explicitly allows for the use of wireless technology in the delivery of NGA, subject to it complying with a set of guidelines on performance.²⁵ The latest NGA guidelines from the EU state as such in paragraph 58:

“At the current stage of market and technological development, NGA networks are: (i) fibre-based access networks (FTTx)²⁶ (ii) advanced upgraded cable networks²⁷ and (iii) certain advanced wireless access networks capable of delivering reliable high speeds per subscriber.”²⁸

Therefore the assertion that the “report...says wireless cannot deliver NGA” is false.

The assertion that “There was no attempt by the UK Government to get over the fixed wireless barriers” is also false. On the contrary, we understand that the UK Government pushed explicitly to include wireless as an NGA technology, both in the guidelines and in the UK decision, in spite of the known issues with its performance. This view is explicitly confirmed later in the PAC hearing by John Zeff where he says:

Q199 (Jon Zeff): “on the point of fixed wireless—this was one of the issues that we had some discussion about with the European Commission because in their guidelines they had specified that they did not believe that fixed wireless solutions were capable of offering next generation quality provision. We worked very hard. It was one of the bone of contention issues with the Commission on our State aid discussions. We got to a position where we could because we felt strongly that it was important to go on the facts.”

There was therefore no barrier to prevent a wireless provider from bidding subject to them being able to commit to delivering the performance requirements of an NGA network, the same as the various fibre technology or cable options do.

BT has tested fixed wireless broadband access in rural areas using a range of spectrum bands, including in 700MHz (TV white space), 2600MHz (4G bands) and 3500MHz (as used by Mr James’s company), and in a number of different areas of the UK. Our results have demonstrated that the commercially available wireless bands are useful bands for the provision of broadband at standard broadband speeds, but none of them could deliver NGA speeds in rural areas in a commercially viable manner.

Q5 (Nicholas James)—“Broadband Delivery UK was given an opportunity by the EU to apply to allow fixed wireless to be allowed in January, and only last week, when it knew I was coming to this session, did it write the letter.”

Comment 13—As stated in our answers above the State aid guidelines require technology neutrality and indeed explicitly allow for wireless as a technology, and furthermore they refer explicitly to the use of wireless in the UK State aid decision. However any solution seeking to utilise State funds to deliver NGA must meet minimum performance criteria and wireless is no exception. The ability of current wireless technologies to meet these requirements is limited. So while BT is unable to comment on what BDUK may have written to the witness, it is clear that the BDUK State aid decision includes the possibility of wireless as an NGA technology, as long as it meets the NGA requirements, from as far back as the final notification of the EC State aid decision in 2012.

Q5 (Nicholas James)—“My last point is, ...the EU rules make it really clear that each region goes through a period of consultation. It then decides what it wants do and then it has to *have a second consultation....* the opportunity for people to come forward with alternative suggestions was denied... we are not actually following those two very clear guidelines” [Emphasis added]

Comment 14—Mr James’s assertions that “the opportunity for people to come forward with alternative suggestions was denied” and that “we are not actually following those two very clear guidelines” are false.

The BDUK process complies with the two stage consultation requirements. The process set out by the EU State aid rules require a public consultation following the identification of which areas will be covered by the support measure in question.²⁹ There is therefore one public consultation not two and the BDUK process fully follows the EU requirements. The EU guidelines explain this in detail as follows:

“Detailed mapping and analysis of coverage: Member States should clearly identify which geographic areas will be covered by the support measure in question.”

²⁵ Published by BDUK here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/192853/BDUK_NGA_Technology_Guidelines_v2_0.doc

²⁶ The term FTTx refers to FTTC, FTTN, FTTP, FTTH and FTTB

²⁷ Using at least the DOCSIS 3.0 cable modem standard

²⁸ See for instance Commission decision in case SA.33671 Broadband Delivery UK, United Kingdom.

²⁹ Section 3.4 paragraph 78 a) and b)

And

“Public consultation: Member States should give adequate publicity to the main characteristics of the measure and to the list of target areas by publishing the relevant information of the project and inviting to comment. By also verifying the results of the mapping in a public consultation Member States minimise distortions of competition with existing providers and with those who already have investment plans for the near future and enable these investors to plan their activities. *A detailed mapping exercise and a thorough public consultation ensure not only a high degree of transparency but serve also as an essential tool for defining the existence of ‘white’, ‘grey’ and ‘black’ areas.*” [Emphasis added]

The BDUK process requires firstly an Open Market Review (OMR) whereby all current and future investors in an area are invited to submit their coverage plans and this information is then secondly subject to a period of public consultation of the results of the OMR that must be completed prior to a tender to the market being issued.

Q5 (Nicholas James)—“They are still not telling us what they are going to build where. So the so-called 10% is still not clear.”

Comment 15—This statement is false and misleading. The information on the intended BDUK intervention areas is available to Local Bodies at the point of contract. It is a matter for Local Bodies to decide whether they publish it. Northamptonshire has done so. Others can do the same. Or Local

Bodies can respond by telling any organisation whether their proposed schemes are within the intended footprint.

The current arrangement is that Local Bodies have possession of the full data, down to the level of 7-digit postcodes, as to the outline deployment footprint in the intervention area at the time of the contract. They are able to tell communities that ask for the information whether their areas are covered within the BDUK footprint. This procedure is being used to advise dozens of community schemes seeking to make applications to the Rural Communities Broadband Fund (RCBF). It has been successfully taken through to completion in the case of the local scheme under the RCBF in Rothbury in Northumberland.

Northamptonshire is also a BDUK contract in which a specific local area has been excluded from the BDUK footprint in order to accommodate a community scheme.

It is a matter of policy for central and local government, not for BT, to decide whether Local Bodies should publish this information about the intended intervention areas. BT wrote to the Secretary of State for Culture, Media & Sport (prior to the BDUK hearing) saying that if the Department and Local Bodies wish to publish the information on intended intervention areas, then BT would be supportive of their doing so, to enable the public to understand the likely extent of the intervention areas and when deployment is expected to occur.

Furthermore, we also support the position set out by the Secretary of State in her letter that the best method for producing such a plan is for Local Bodies to produce a suitably caveated map of the proposed Project deployment (“Project Deployment Outline Map”), like the example highlighted in Northamptonshire.

It needs to be understood, though, that the exact final footprint of BDUK is subject to a high degree of uncertainty prior to completion of the project what the final project deployment footprint will be.

- Prior to the contract, an open market review process is conducted under the BDUK Framework, to identify all actual and intended commercial footprints, so that the intervention area does not overlap with them.
- At the point of contract, an outline deployment within the intervention area is defined, but this is still subject to survey. Some areas within the outline footprint may not in the end be covered (for example, because of unexpectedly high costs of deployment), while some other areas outside the outline footprint may yet be covered.
- Once surveys are completed, it is possible to provide greater certainty as to the planned footprint. Surveys, planning and deployment are conducted in phases, such that different parts of the deployment footprint within the intervention area will be determined at different times.
- Even after all the surveys and planning have been accomplished the final deployment footprint within the intervention area is still not certain, because the BDUK contract requires a gain-sharing arrangement. If take-up exceeds the forecast, then profit made on the additional customers is clawed back. The Local Bodies can use their share of the claw-back to reinvest in further deployment footprint within the intervention area.

As a result, the actual built footprint within the intervention areas will always carry some degree of uncertainty, subject to surveys, subject to change on planning and subject to change on incremental investment until the deployment is complete. The deployment plans that BT has agreed with Local Bodies are merely indicative at the time of contract and are subject to survey, planning, deployment issues and changes during the course of the project. For example in Cornwall, which although not under the BDUK programme is following an equivalent deployment plan and is much further forward in the deployment process, the original

planned build footprint was 84% of premises. This has now been increased to a build footprint of 92% of premises as a result of a range of improvements in the deployment.

Q9 (Mr Smith and Nicholas James)—“Who influenced them [to reduce the target from 100% NGA coverage]?” “It has to be BT.”

Comment 16—The question “who influenced them [to reduce the target from 100% NGA coverage]?” is based on a false premise. As detailed in comment 3 above, the targets for the BDUK programme were set out in the BDUK delivery programme document at the start of 2011 and there never was a target of 100% NGA. There was no 100% NGA target, so no such reduction and no such influencing occurred. On the contrary, our corporate objective is to extend NGA as far as possible into areas that cannot be reached by commercially funded infrastructure. We support further government funding to push further into the final un-served areas.

Q11 (Malcolm Corbett)—“However, in rural areas where you already have one incumbent which, by definition, has the only network in those areas, and if the challengers cannot get access to any of that existing infrastructure to help make their business case stand up better, then it is very challenging.”

Comment 17—As set out in comments 9 and 10 above, BT does not have a fibre network in these areas. The witness’s statement is incorrect on a number of points.

Firstly, in the rural areas targeted by the BDUK programme for the delivery of a superfast broadband network services neither BT nor any other operator is present in superfast broadband and therefore no one “has a network.” There is no specific market for superfast broadband and so BT cannot hold an incumbent, or any other, market position.

Secondly, challengers can get access to existing infrastructure as explained above in comments 8 and 9 in particular. Openreach, BT’s access network division, is subject to, and fully compliant with, the toughest regulatory standards in the world. These include “Equivalence of Inputs” requirements, by which Openreach has to provide exactly the same services on exactly the terms in exactly the same way to BT’s own operations as to all other wholesale customers. EOI applies to all Openreach’s active wholesale products—Generic Ethernet Access (GEA)—which underpin competitive superfast broadband supply in the UK (in fulfilment of Ofcom’s Virtual Unbundled Local Access requirements (VULA)) and also passive infrastructure access whereby any other operator seeking to deliver SFBB services can use BT ducts to install their own fibre. BT’s network assets are therefore available to any other provider seeking to deliver an NGA network and this fact could have been utilised to compete with BT in these bids.

Q11 (Malcolm Corbett)—“BT were pushed very hard by BDUK and Ofcom to create an offering, to create a passive infrastructure access prompt [sic, probably intended as product]—something which would allow people to actually make use of the existing ducts in the ground and the telegraph poles that we use for these networks. However, all of the non-incumbents concluded that it was so hedged-around with commercial caveats that it became unusable for them: they could not use it for business-grade services, to link communities that they were building local networks in back to the internet, the so-called backhaul connection, or to run mobile phone masts. They had restrictions on other aspects like having notices to quit of 30 days on the infrastructure and a whole range of different things like that meant that nobody felt able to use it.”

Comment 18—Mr Corbett’s statement that other bidders cannot “make use of the existing ducts in the ground and the telegraph poles that we use for these networks” is false.

Ofcom have reviewed, consulted on and accepted the prices, terms and conditions for BT’s duct and pole products and BT is subject to a wholesale access obligation on passive infrastructure access, to all its ducts and poles in rural areas, at cost-orientated prices on regulated terms governed by Ofcom. These products enable SFBB network operators to utilise BT’s ducts and poles to build their own network if they wish. The prices for this PIA product were finalised and released to the market in October 2011 at rates well below those of other comparable EU markets. In fact at the time of publication they were 38% below the European average.³⁰ The terms and conditions associated with the Openreach PIA product are fully reviewed and approved by Ofcom and came about following Ofcom’s review of the Wholesale Local Access Market (WLA)³¹ concluded in October 2010 and were specifically intended to deal with competition in superfast broadband. The key findings of Ofcom in that review were:

“1.3 One of the main challenges facing Ofcom is to adapt the existing regulatory framework to reflect the emergence of superfast broadband. Over the past two years commercial investments in next generation access (‘NGA’) networks have resulted in super-fast broadband being made available to nearly half of all UK households. However, competition in the provision of superfast broadband services remains in its infancy. To support the future development of the market, it is essential that there should be a clear regulatory framework designed both to promote competition and to support continued investment and innovation.

1.4 This document sets out the conclusions of our review of the UK market for Wholesale Local Access (‘WLA’) and is intended to establish such a framework. We have found that BT continues to have significant market power (‘SMP’) in the UK market for WLA services, and concluded that

³⁰ <http://www.btplc.com/News/Articles/Showarticle.cfm?ArticleID=BCC96D42-80DF-4F6E-8436-24A35F8C0858>

³¹ <http://stakeholders.ofcom.gov.uk/consultations/wla/statement>

access to BT's local access network remains critical for those companies seeking to compete in the delivery of downstream services such as broadband and traditional voice services. On the basis of that finding, we have imposed a number of regulatory obligations on BT, designed to support investment and competition in superfast broadband, as well as in current generation services.

1.5 The new regulatory model rests on the following core elements:

- Virtual Unbundled Local Access ('VULA'), which will allow competitors to deliver services over BT's new NGA network, with a degree of control that is similar to that achieved when taking over the physical line to the customer;
- Physical Infrastructure Access ('PIA'), which will allow competitors to deploy their own NGA infrastructure between the customer and the local exchange, using BT's duct and pole infrastructure, to provide broadband and telephony; and
- Local Loop Unbundling ('LLU') which we expect will continue to provide a basis for competition in current generation services, allowing competitors to physically take over (or share) BT's copper lines between the customer and the local exchange.

1.6 We expect the new regulatory remedies (VULA and PIA) to be used in different circumstances: VULA is likely to be the most attractive for communications providers ('CPs') where BT has already upgraded its local access network; PIA will be attractive to companies wishing to address market opportunities in advance of BT and may also be of particular interest to companies wishing to provide service in locations which may be in receipt of public funding support."

All of these remedies were in place prior to the BDUK process, thereby enabling the full range of competition options envisaged by Ofcom to come into play in the BDUK bids. BT made significant systems and product investments to create its PIA product portfolio. We successfully tested and trialed these products with wholesale customers. They are fully compliant with all regulatory obligations, to the toughest standard in the world. There have been no disputes about them lodged with BT or with Ofcom.

Q11 (Malcolm Corbett)—"That should be done on a fully open access basis. In other words, we should encourage people to be able to use that infrastructure for competition, not just at the level that BT wants other companies to use it, at the so-called active layer, but right down to the passive layer. That is in line with EU rules and competition rules."

Comment 19—Mr. Corbett's statement that infrastructure is open "just at the level that BT wants" is false.

As detailed in the answers above not only is BT's network open at both the active and passive layers, as the witness has requested it should be, but these access options are offered in full accordance with the market review conducted by Ofcom and concluded in October 2010 and detailed in our answer above. Openreach's network is by far the most open access wholesale network in the world, at both the active and passive layers.

Q11 (Malcolm Corbett)—"Secondly, there is a problem with service providers like TalkTalk. I am sure Dido will speak about this herself in a little while. Service providers operate on very thin margins—ISPs, that is."

Comment 20—This assertion is incorrect. According to Mrs Harding in her results presentation to investors,³² the selling of fibre broadband is accretive to revenue and profitability and the costs of subscriber acquisition are paid back in 18 months. Contrast this with Openreach's roughly 15 year pay-back on investments for BDUK.

Q11 (Malcolm Corbett)—"I think Nick has explained the problem of consortia building, which meant that really none of the consortia could see how they could work. As a consequence we have *no competition on this programme*, and we have lost a lot of investment that could come into this sector. So Fujitsu were offering £1.5 billion into this process."

Comment 21—These assertions are false and contradicted by the facts. The facts are that Fujitsu, a global public corporation, one and a half times larger than BT Group, with a large field force of communications engineers in the UK (which BT used to contract with), had publicly declared their willingness to invest £2 billion in fibre investments in support of the BDUK scheme and announced plans in April 2011 to work in a consortium with Virgin Media, TalkTalk and Cisco to deliver fibre to some five million UK premises.³³ It therefore appears that they were very committed to a consortia approach and were prepared to back this with very substantial financial investment. It is therefore difficult for BT to see why the witness has raised consortia building as a problem in the BDUK process.

Given the very credible announcements made by Fujitsu at the time it is therefore false to say that there was "no competition on this programme."

³² Talktalk results presentation 24 July 2013 <http://www.talktalkgroup.com/~media/Files/T/TalkTalk/pdfs/reports/2013/q1-ims-2013.pdf>

³³ Fujitsu press release 13 April 2011, http://www.fujitsu.com/uk/news/pr/fs_20110413.html

Mr Corbett's allegation that there was "no competition in this programme" is also not consistent with his own published views at the time. In his blog at the time of Fujitsu's announcement he said:

"Finally, competition in the Final Third: With another scale player in the frame BT now has serious competition and local authorities have more choices on the table. Secondly Ftel [ie Fujitsu Telecom] brings with it some key players on the services side—both Virgin Media and TalkTalk."

Mrs Harding also said "competition from Fujitsu brought down BT's prices." The competition at the outset of the process led BT to accept that the BDUK projects will have a pay-back of about 15 years, considerably longer than its normal commercial investments.

Q11 (Malcolm Corbett)—"BT last year promised £1 billion into this process at the House of Lords Committee. The National Audit Office has said that has turned itself into £356 million."

Comment 22—The statement from the NAO that BT has only contributed £356 million is not correct. We have provided a detailed breakdown of the expected costs in a separate paper—see the attached Annex 1.

The NAO has chosen to count only the capitalised costs and to ignore the operational costs BT will incur in rolling out and running the network. That is an error in their analysis. We are not able to capitalise all the costs required to fulfil our obligations under BDUK contracts. However, these non-capitalised costs (amounting to an additional circa £250 million in relation to the contracts signed at the time of the NAO report) are equally legitimate contributions of shareholder capital to the BDUK roll-out programme along with the costs of the BDUK procurement process. If BT secures all the BDUK contracts, we expect to be committed to over £700 million of capitalised and operational costs in deploying NGA in BDUK areas. As a result across the publicly subsidised contracts that we have won and we may win from BDUK, plus the publicly subsidised Northern Ireland and Cornwall contracts, BT will be contractually committed to spending over £800 million, (with £600 million already contractually committed), a bit less than half of which will be capex costs (the rest is operational expense in deploying the networks) and over £800 million when including Northern Ireland and Cornwall.

Our commitment at the beginning of this process was that we would put up to a further £1 billion (further to the £2.5 billion of costs we are incurring in our own commercial deployment) to match £830 million of central government money, including Cornwall and Northern Ireland, a ratio of 120% of central government contribution. This was stated as "We are willing to spend a further £1 billion or so of BT's capital" during the House of Lord's oral session. The £1 billion of capital represents all of the cash spend by BT to build these networks whether it is capitalised or expensed. To date BDUK has allocated only £462 million of its funding to Local Bodies, but we will have put in over £700 million to match it, a ratio of 150% of central government funding. In other words our current contribution is greater than expected not less.

As well as capitalised and non-capitalised costs, BT is also contributing all of the wholesale revenue and profits arising from the use of the network from the sale of fibre products to BT Retail, TalkTalk, BSkyB and other CPs. This is a particular feature of the gap-funding model which safeguards public value for money, that all the revenues and profits from the infrastructure are used to reduce its costs over the whole life of the ten year contracts, even though the contracts themselves will not pay-back to BT in these timescales.

Q11 (Malcolm Corbett)—"As a consequence, we now have a situation where State aid intensity in this programme is 77%; so every pound that is going to get spent—77p comes out of us, the taxpayer. If you go to Sweden, and you go to deeply rural areas of Sweden, you will find precisely the opposite."

Comment 23—This claim is false and the approach taken in Sweden is not comparable.

As stated above the 23% estimate of BT's contribution is an error in the NAO report.

The Swedish solution is not comparable with the BDUK scheme. The Swedish model relies on building a passive duct infrastructure only, with significant contribution from the State. Service providers then need to install fibre or buy dark fibre to offer a service. Such an approach is expensive particularly in rural areas (a recent news article³⁴ highlights this as some **£12 billion to date or SEK 121 billion of government funding** to 417 projects with a total reach of some 420 miles of ducts). This makes it much more expensive an approach than the BDUK scheme. The approach also has negative consequences that it undermines competition in unrelated markets, risks overbuilding existing infrastructure and does not attract ISPs to offer competing services, as they need to rebuild services and software to offer existing products over the new infrastructure and have separate service engineers for maintenance and installation.

Q11 (Malcolm Corbett)—"This was highlighted hugely in the National Audit Office Report—the issue of transparency. There is a huge issue of cost transparency—transparency over BT's costs. It is very unclear exactly how they are going to spend money and whether we are really genuinely going to get value for money."

Comment 24—The statement by Mr Corbett that "There is a huge issue of cost transparency" is false. As explained repeatedly at the hearing, BT is providing 100% auditable transparency of the actual costs it claims under BDUK contracts.

³⁴ <http://www.telecompaper.com/news/swedish-public-funds-for-broadband-ducts-reach-sek-121-blm—959808>

Every single item of cost will be evidenced and auditable. Where there are cost overruns, BT incurs them. If there are revenue shortfalls, BT takes the loss. If take-up and revenues overshoot, the gain is in the Government's favour.

The NAO report³⁵ recognises this and actually states: "The process seems robust and, in particular, should allow Local Bodies to validate that equipment costs are correct."

Q11 (Malcolm Corbett)—"We have also got a big problem with transparency over BT's roll-out: where they are going to go and where they are not going to go. There are many other providers around the country who are delivering future-proof networks today, both in the community sector and the private sector. All of those face the danger of being overbuilt—having their networks overbuilt by BT turning up with State funding."

Comment 25—This statement on transparency of information is false the information is available to Local Bodies and is being published eg in Northamptonshire, please see comment 14 above: it is a matter for Local Bodies to decide whether they publish their intended footprint.

In relation to the issue of overbuilding, Mr Corbett's allegation is false. There are two stages in the BDUK process. At the beginning, there is an open-market review in which bidders declare where their actual footprint is at that time and where their intended commercial footprint will be so that they can all be excluded from any public subsidy. The results of the OMR process are then made available for public consultation to test their accuracy and to enable comment/challenge. Only after this public consultation stage does the Local Body issue its tender. If there were commercial opportunities in any part of the country including commercially funded community schemes, they will be excluded from the intervention area by the OMR process. BT strongly supports this being the case. We do not want any of this public money being used to over-build commercial opportunities.

If there are other publicly subsidised schemes in BDUK areas, then of course it is necessary to ensure that the same area does not get public subsidy from two different sources. We are not aware of any instances where this has been happening.

Q11 (Malcolm Corbett)—"Local authorities are extremely fed up with this process—they hate the fact that they are faced with a procurement in a competition with only one competitor."

Comment 26—We have not heard this from local authorities and we are not aware of any evidence supporting such a sweeping claim.

Q13 (Malcolm Corbett)—"One local authority was very supportive of one of the local rural community broadband fund projects. That is a small scheme of only £1 million, designed to support innovative projects in very rural areas. The chief executive of that local authority was very supportive of one of the local schemes; she publicly said that she thought it was great. It is an absolutely fantastic project. She was then told by BT that if she continued to provide that public support her county would go to the bottom of the queue."

Comment 27—We have seen no evidence to back up this assertion from the previous witness. BDUK contracts include change control provisions, which allow for the customer and the supplier to make changes as may become necessary. A change in the intervention area is one such possible change. If a Local Body wishes to change the intervention area, for example to accommodate a community broadband scheme, then the contractual change control provisions are the mechanism by which this may be achieved. The result will inevitably be a period of delay, as the BDUK intervention area will have to be redesigned. The length of the delay will range from a few months to perhaps many months, depending on whether the change in the intervention area is small, defined and concentrated or large, ill-defined and widespread.

Q15 (Mr Bacon)—"Given the behaviour of BT in relation to the national programme for IT in the health service, where in many cases it basically blackmailed local health providers, that does not surprise me at all."

Comment 28—An allegation of blackmail is an extremely serious matter, even within the confines of Parliamentary Privilege. BT strenuously objects to its use in relation to any of its conduct in any field, and robustly denies any such allegations.

Q18 (Malcolm Corbett)—"The target used to be the best superfast broadband network in Europe by 2015. Earlier this year, BDUK announced that it wanted to have a transformation of broadband. We are no longer going for the best in Europe."

Comment 29—The statement that "We are no longer going for the best in Europe" is false.

One objective of the BDUK programme is to deliver the best superfast broadband network in Europe in 2015. This objective is still very much in place. BT believes that this will be achieved. Ofcom published its EU Broadband scorecard in March 2013³⁶ in order to provide evidence on progress towards the Government target. According to the Ofcom scorecard the UK is currently 1st in eight out of the 12 measures when compared with the peer group of major European economies. According to Ofcom, the UK already has 73% coverage of superfast broadband. We support the NAO's conclusions that 88% coverage is achievable in BDUK

³⁵ 27 at page 39

³⁶ European Broadband scorecard March 2013, <http://stakeholders.ofcom.org.uk/market-data-research/other/telecoms-research/bbresearch/scorecard>

areas by 2015. We believe this will put us at the top of the European superfast broadband league among the major economies.

Q19 (Malcolm Corbett)—“Mathew Hare, the chief executive of Gigaclear, has written to Ed Vaizey in the past few days, complaining about the fact that BT is turning up to villages where it has people working to organise demand, saying, ‘Don’t worry your pretty little heads about Gigaclear. We’re going to turn up here with our State funding soon, so you don’t need to bother with this project.’ There are even some examples of where that apparently has not been true.”

Comment 30—There has been no evidence to back up this assertion from the witness. Without specific evidence it is difficult for BT to comment or effectively challenge the accusations. This accusation should therefore be substantiated with evidence which can be investigated or accepted by the witness as false.

Q24 (Dido Harding)—“Today, BT takes approximately a 30% to 35% market share of copper broadband connections. On its network, so excluding Virgin for a second, it accounts for more than 85% of superfast broadband connections.”

Comment 31—This statement is misleading at best. BT has less than half the retail superfast broadband market. Virgin Media is the largest provider in the market currently so “excluding them for a second” completely misrepresents the market as it exists in the UK today. It is true that BT currently has 85% of superfast broadband customers using Openreach’s regulated wholesale products. This is because Openreach’s superfast broadband product is still in its early stages and because BT Retail started heavily marketing superfast broadband two years before TalkTalk and Sky, even though fibre access products were made available to TalkTalk and Sky at exactly the same time and on exactly the same terms, as to BT. It was equally open to TalkTalk to start marketing superfast aggressively at the time that BT Retail did. Recently, however, presumably in response to the significant increase in superfast connections in the UK market for BT Retail and Virgin Media, TalkTalk and Sky have started to market their fibre services, which of course utilise the same Openreach fibre network as that used by BT, and on the same terms as BT Retail. The results of this marketing activity are now showing through in the latest quarterly market figures announced showing roughly 25% of new fibre customers in the first quarter of 2013–14 came from communications providers other than BT Retail. Thus the position is changing and we would expect to continue to change as other sellers actually develop their marketing and brand awareness.

Q24 (Dido Harding)—“The reality is that BT is behaving like a very intelligent and well-run monopolist.”

Comment 32—BT is not a broadband monopolist. As was pointed out by Ms Harding in Q24 BT has only 30% retail market share in standard broadband. The only market in which we are the single supplier is of copper lines in areas where others have chosen not to deploy networks.

In terms of actual customers connected BT has a smaller superfast broadband market share than Virgin Media (1.3 million connections out of a total of 3.8 million in the UK market as at the first quarter of 2013 according to Ofcom’s latest Communications Market review). Even in terms of its superfast network availability, it was only in December 2012 (when BT had passed more than 15 million premises to equal the existing Virgin Media footprint) that BT got to a position where there were more premises accessible on its fibre network than Virgin Media’s cable network. BT is also not a monopolist in standard broadband.

Q24 (Dido Harding)—“If BT is not properly regulated going forward, you might have the network built, but people will not be using it. 60% of the population today could take superfast broadband if they wanted to. Only 6% actually do. That is in large part because it is too expensive.”

Comment 33—BT is properly regulated today by Ofcom and there is no expectation that this will not continue in the future. This statement is therefore conjecture with no basis in fact. The Committee should bear in mind that Openreach, TalkTalk’s supplier, is regulated on the Equivalence of Inputs standard, the toughest regulatory standard in any telecommunications market in the world. This means that it must provide products and services to communication providers (CPs) on an equivalent basis:

- at the same prices;
- using the same processes; and
- to the same timescales.

We provide different service levels at different prices and Service Level Guarantees, but these are the same for all CPs.

The claim on take-up that “only 6% [of customers with access to Superfast] actually do” is false. The take-up rate of superfast broadband in the UK is faster than all other comparable countries, including all the other big-four European economies, especially this early in the deployment of SFBB. At the end of 2012, BT had more fibre broadband customers (over 1.2 million) than Deutsche Telekom (905k). UK take-up of SFBB is about twice that of Japan at the equivalent point in the deployment in terms of total households and penetration of households passed. At the most recent annual results, BT declared take-up of superfast broadband of over 10% in its fibre footprint. That is remarkably high by comparison with other countries at this stage of

development. Further, in the latest Ofcom Communications Market report³⁷ this increasing take-up of superfast services is further confirmed as the report, published on 1 August 2013, states that:

“Take-up of superfast broadband services has doubled since June 2012. The number of subscribers to superfast broadband services increased from 1.9 million in Q2 2012 to 3.8 million in Q1 2013, resulting in **17.5% of total fixed broadband connections being classed as superfast** by the end of March 2013.”

The OECD in its latest Communications outlook report 2013³⁸ has also recognised that prices for superfast broadband in the UK are the lowest of major European countries. TalkTalk has complained to Ofcom that BT is selling fibre to cheaply which is inconsistent with saying BT’s price is too expensive.

Q24 (Dido Harding)—“We, as a customer of BT, have lodged a Competition Act complaint with Ofcom, which it has opened, because we think that BT is charging too much for wholesale access to superfast broadband.”

Comment 34—TalkTalk has not, in fact, lodged a complaint with Ofcom that Openreach is overcharging for wholesale access to superfast broadband. It has lodged a margin squeeze complaint, which concerns the margin between the prices charged at the wholesale level by Openreach and the prices charged at the retail level by BT Retail. The allegation is that it is impossible for TalkTalk (or other competitors) to sell its retail superfast broadband product profitably in competition with BT Retail’s price because there is insufficient margin between the Openreach wholesale price and the retail price. However, TalkTalk also told investors at its results announcement that fibre broadband was accretive to its revenues and profits and achieved pay-back of the costs of customer acquisition in 18 months. This statement implies that TalkTalk is able to offer customers a commercially viable product with existing wholesale prices and is thus incompatible with an assertion that BT is margin squeezing.

Q26 (Mr Bacon)—“BT would rather have a low-volume, higher-margin model than see it spread out as quickly as possible.”

Comment 35—This statement is mistaken. BT’s strategy is exactly the opposite, namely low pricing for higher take-up and this strategy is working with the UK having lowest fibre broadband prices of major EU countries according to the OECD and superfast take up at over 17% of broadband lines according to Ofcom. This approach is further demonstrated by the fact that BT charges roughly the same price for superfast broadband as for copper broadband, in order to make it as easy a choice for customers to choose fibre as possible. Indeed this is the essence of TalkTalk’s margin squeeze complaint, that our retail pricing is too aggressive, given that the wholesale costs for fibre broadband are higher than for copper broadband, as Mrs Harding stated to the Committee in the course of its hearing (see Mrs Harding’s comments in relation to question 28 below).

Q26 (Dido Harding)—“I think it is a game of timing. BT would like to have an unregulated fibre market for as long as possible.”

Comment 36—This statement is incorrect. BT’s wholesale fibre products are already regulated as stated above (see comment 33 and others) to the demanding EOI standard. The only aspect of regulation that has not so far been applied is price regulation. This is because Ofcom had no basis for setting regulated prices at the time of the launch of the new fibre product, did not want to discourage investment in new infrastructure and saw competition from existing broadband as well as Virgin Media’s cable service as a pricing constraint. Ofcom has recently confirmed its view that GEA should not be price regulated for the period of the next market review, for the same reasons.

Q26 (Dido Harding)—“There is a real first-mover advantage in acquiring customers and doing so as fast as you possibly can before the regulator catches up with you.”

Comment 37—The assertion that BT is “acquiring customers...fast as you possibly can before the regulator catches up with [us]” is false.

BT is obliged under the undertakings given to Ofcom in 2005 to ensure that wholesale access products are available to all communications providers on equal terms before it is able to launch retail services itself. This obligation was fulfilled when the GEA product was launched in 2010. It was equally possible for TalkTalk (or Sky or any other ISP) to enter the superfast broadband market at the same time as BT. The fact that it chose not to do so, and to enter the market in significant volume only in 2013 is entirely a matter of its own commercial choice and not a matter for which BT is culpable. We understand however that one of the reasons for delaying entry to this market was in order to assess the scale of the likely superfast market in the UK and thus if it justified the systems and product changes for the ISP to offer these services to its customers. With the number of BT retail SFBB customers now well over a million, this presumably justifies the significant increase in marketing effort we are now seeing from other ISPs to gain share in this market.

³⁷ Ofcom Communications Market report 2013, <http://stakeholders.ofcom.org.uk/market-data-research/market-data/communications-market-reports/cmr13/>

³⁸ http://www.keepeek.com/Digital-Asset-Management/oced/science-and-technology/oced-communications-outlook-2013_comms_outlook-2013-en

Q28 (Dido Harding)—“[BT] is not passing on the cost of fibre to their consumers. I have to pay £8 a month extra per customer per line for a fibre connection. BT Retail manages to sell fibre at basically the same price as they do copper. That is the basis of our margins squeeze concern....The way that you get value for money from the £1.2 billion is actually from whether there is take-up and whether the prices are low enough. The two are intrinsically linked. It is not just about whether the network is built.”

Comment 38—There is some inconsistency in Ms Harding’s comments in that they acknowledge the importance of driving superfast broadband take-up and whether prices are low enough, while also suggesting that BT’s retail pricing is too low. However, on the point of take-up and value for money, we would agree with Ms Harding that getting take-up onto the network is key to delivering value for money both for BT’s investment and for the Government’s investment. BT needs take-up levels to reach 20% in order to make its business case whole and at take-up levels in excess of this in BDUK areas the Government starts to get increasing value for money as a result of the claw-back and re-investment clauses in the contract that result in ever greater coverage in the BDUK areas for no additional government funding.

Q29 (Dido Harding)—“What is happening at the moment is that 90% of its fibre connections are on its own in-house retail outlet, rather than ourselves, Sky or any other of the 60 or 70 retailers of its fibre products. We account for next to nothing of its volume.”

Comment 39—It is false to imply that non-BT communications providers “account for next to nothing of its volumes.” On the contrary, in the last quarter nearly 70,000 or over 25% of the 265,000 new fibre lines were sold by non-BT communications providers. This share is growing rapidly as the volume ISPs, such as TalkTalk and Sky, begin to market fibre broadband services in earnest.

BT took the risk of investing in new fibre based products and systems at the retail level that utilised the Openreach network at the outset. Sky and TalkTalk held off on these investments until more recently (and they still only sell the lower speed 40Mb/s fibre product rather than the higher speed 80Mb/s product) presumably as they were unconvinced of the market demand in the UK for these services until now.

BT has between 60 and 70 retailers using its fibre infrastructure currently, which is without parallel in the world for the scale and effectiveness of its wholesale fibre access products. BT Retail chose to sell superfast broadband two years before TalkTalk, although TalkTalk could have entered the market at this time. This is the principal reason we currently have more retail customers on fibre on the Openreach network and why TalkTalk “account for next to nothing of its volume.” BT has also invested heavily in marketing of its fibre services over the past two years to kick start the fibre market. This risk taking by BT, which is helping overall UK take up of superfast services, is criticised whilst others take a “wait and see” policy.

Q31 (Dido Harding)—“We were very involved with Fujitsu as one of the potential competitors. I would dearly have loved any of the alternatives just to bring some competition and an alternative choice for me to buy services from. We worked very hard and closely with Fujitsu in particular. In the early days, the engagement of alternative providers definitely brought BT’s prices down.”

Comment 40—It is false to imply that there was no competition in this process. Fujitsu, a larger company than BT, teamed up with TalkTalk, Cisco and Virgin Media, and was a highly credible competitor. Our bids were submitted in this competitive context and the terms intended to compete with Fujitsu are those that apply now. We therefore agree with the witnesses’ remarks that the engagement of alternative providers, particularly Fujitsu, brought down BT’s prices.

Q32 (Dido Harding)—“Today, in our copper broadband market, we actually have one of the most competitive retail markets in the world. We have one of the lowest prices and the highest take-up rates. They are all intimately linked.”

Comment 41—We agree with this proposition: the UK retail broadband market is well known to be among the most competitive in the world, with amongst the lowest prices and amongst the highest take-up. It is notable that Ms Harding previously criticised the fact that BT Retail was charging the same for superfast broadband as it does for copper despite the higher costs of providing fibre broadband access. This obviously means that prices for superfast broadband in the UK are also amongst the lowest in the world. Clearly doing this is a great way to increase the take-up of superfast broadband.

Q35 (Nicholas James)—“Dido might be right, they might have dropped their prices by so much, but we are going to use a mix of technology in order to deliver 100% because if you deploy multiple technologies, you can do more for less money, but, if you employ a single technology, you are stuck with that.”

Comment 42—It is false to say that BT is using a single technology solution and we are stuck with that. On the contrary, we are using a wide range of solutions, including fibre to the cabinet, fibre to the premises, fibre on demand, broadband accelerators and regenerators, Broadband Extension Technology, plus the potential for wireless, especially for cabinet backhaul, and satellite broadband for the hardest to reach premises among other technologies.

For example, in Cornwall, fibre coverage extends well into the last 10%, where we are now looking at 95% coverage from an initial prediction of 81%. Beyond the fibre footprint, other in-fill solutions will be appropriate. We can address the 5% non-fibre areas with a mix of technologies (potentially satellite, Broadband Regenerators (BBRA) ADSL2+ etc) and wireless could be useful in situations where 90–95% of coverage is possible.

It is also notable that Mr James statement implies an acceptance that BT did price competitively to win BDUK contracts. We made our bid under competitive pressure in the framework negotiation and these are the same prices that apply in all the call-off contracts.

Q35 (Malcolm Corbett)—“Something else that is worth saying is that there is a capacity constraint issue here. We know that, according to the National Audit Office, fewer than 10 of the counties will get delivery by 2015, when it was supposed to be all of them.”

Comment 43—It is false to say that there is a capacity constraint. There is no issue of capacity constraints and none of BT’s projects are late. We said to the Government at the outset that, if BT were selected for all contracts, it would take until the middle of 2017 to get it all done. We are still on track to deliver all the deployment in 2017. This is despite the nine-month delay in getting State aid approval, finishing the framework and getting the first contracts through the process. We were not responsible for the timescales set by the BDUK modelling work pre bid and any government targets for completion set on the basis of this. The BDUK delivery plan objectives never mention 90% by 2015—this was actually a target set by a government minister in a speech not in the BDUK objectives. BT had no involvement in this speech and always advised that a realistic target would be 2017 to achieve above 90%.

Q38 (Mrs Hodge)—“You said you were going to spend £1 billion ... where is that £1 billion?”

Comment 44—As explained above (see comments 21 and 22), BT’s commitment was to spend up to a further £1 billion of its own funds (in addition to the investment of £2.5 billion in its own commercial deployment). This is still the case but as expected our outlay will be a mix of spending that is both capitalised and expensed to deliver the network and we expect that up to £1 billion of BT funds will be committed to matching central government funding (expected to be £830 million, to roll-out fibre broadband in rural areas). In fact central government funding for BDUK has so far only been £460 million, and BT’s contribution is expected to be over £700 million in relation to these current funds. We expect our contribution to publicly subsidised fibre roll-out including Cornwall and Northern Ireland to be over £800 million already. If central government allocates further funding to rural broadband rollout, in line with the announced investment of £250 million, and if BT were contracted to use this funding for further fibre rollout, then our contribution is likely to be in the order of £1 billion, perhaps more. This is explained further in Annex 1.

Q51/52 (Mrs Hodge)—“In the Northern Ireland contract, as far as I can see, the public subsidy was about 37%. It was a subsidy of £14,000 for each cabinet and path ... In the UK, the subsidy is £47,596 for a cabinet and path on a total cost of over £61,000, according to the NAO Report. In Northern Ireland, the total cost was £37,787. The subsidy has massively increased, although my understanding is that it is easier to do it in the UK than it was in Northern Ireland.”

Comment 45—The subsidy has not massively increased. As stated in the NAO report, the difference in costs in deploying cabinets in Northern Ireland versus those deployed in Great Britain is 12%, £25.5k per cabinet in Northern Ireland versus £28.8k per cabinet in GB.³⁹ We provided this information to the NAO. There are many reasons for the difference in costs and thus levels of subsidy required, including the following:

- Labour rates are cheaper in Northern Ireland, for civil engineering work.
- Cabinets in Northern Ireland do not have to have power meters, whereas power companies in GB have insisted on each having a power meter. That saves about £500 each.
- It is a single solution in Northern Ireland, and a different specification of the network.
- The intervention area was defined four years earlier in Northern Ireland, at a time when there was less commercial deployment so it swept up some cheaper cabinet areas.
- Different rurality in Northern Ireland (eg with rural premises distributed in more isolated clusters in rural mainland compared to Northern Ireland) which affects network costs and speeds received by end-users.
- Different network topography, with longer lines from the cabinet and shorter backhaul distances.

Q58 (Mrs Hodge)—“Why are you resistant to total openness?”

Comment 46—BT is not resistant to openness. BT is providing a huge amount of openness in the costs and associated spend in the BDUK process. 100% of all our actual costs incurred and claimed under BDUK contracts are only payable on presentation of detailed invoices, which are auditable. The NAO Report raises concerns that there will be so much information provided that Local Bodies and BDUK will have to make sure they have enough expertise and capacity to deal with them. This is the same approach that has worked successfully in Cornwall, where we have provided the County Council 18,000 items of invoicing in a recent audit. These, along with samples provided along with the quarterly claims have been reviewed and audited and have been given an unqualified result (Up to December 2012).

Q59 (Mrs Hodge)—“What is the average contingency across all your contracts?”

Comment 47—The average contingency is as stated in the hearing. We would re-emphasise the point made during the hearing that BT cannot charge for contingency. We can only charge for actual costs as evidenced by bank statements, invoices and timesheets. Contingency is not a cost to the public purse—we only can claim

³⁹ NAO report Page 35 Figure 13

what we ACTUALLY spend. It is important that the Committee understands this as it appeared not to in the hearing.

Q67 (Malcolm Corbett)—“What about the non-disclosure agreements?” ... We have put in freedom of information requests and they have all come back saying, “This is commercially confidential information that cannot be released.”

Comment 48—It is quite typical for commercial contracts to contain non-disclosure agreements. These cover a range of commercially confidential information, including costs and prices. The BDUK contracts similarly contain such generic non-disclosure provisions. It would, for example, not be appropriate for BT’s commercially confidential network costings to be disclosed to competitors. These NDAs need not impede Local Bodies giving guidance to community schemes as to where the BDUK footprint is expected to be. As explained in comment 15 above, Local Bodies can answer enquiries and give guidance on where the footprint is expected to be, and are doing so successfully; further the supplier and the Local Body are able to agree that the footprint can be published, as has been done in Northamptonshire. We have suggested to the Department that they could seek to have the footprint published at the time that the contract is signed.

Q75 (Malcolm Corbett)—“BDUK... asks BT to do a change control on that [a rural community broadband project or any of the other ones], then asks BT to do a change control on that contract and then pays BT to do to an impact assessment of that change control.”

Comment 49—When BDUK contracts are signed, the outline footprint within the intervention area is defined. Naturally, if there is a minor change in the Local Body’s requirements after contract, or indeed in BT’s proposals, it is necessary to go through a contract change control process. There is nothing remotely problematic with such an arrangement. It is good contractual working practice.

Q75 (Malcolm Corbett)—“Local projects on average are looking for 25% to 40% State aid.”

Comment 50—We are not aware of the details of bids from local projects for any local funding as any such bids would need to be made in accordance with EU procurement rules and thus BT would not be in a position to see such details unless we were part of the bid. However if these local projects are able to meet the requirements of State aid, deliver the coverage and take-up commitments required, and do this at better value than a competing bid from BT then they would presumably win the procurement. To date we are only aware of one such local project contract, in Rothbury, which was won by BT.

Q100 (Mr Morse)—“It is difficult to compare the commercial framework because you have not agreed access rights for the Department, have you?”

Comment 51—There was some confusion over transparency in the hearing. The facts are these. All the costs of the BDUK programme are inspectable and auditable. None of the costs of our commercial programme are inspectable and auditable. There is no reason why the commercial programme should be open to external audit, because these costs are unrelated to public subsidy. They are a matter for shareholders alone, and audited in the ordinary accounting and financial control of BT Group plc.

Q105 (Malcolm Corbett)—“The person who was sitting on the other side of the table is sitting right behind me, the chief executive of the North Yorkshire network at the time. I think that he would agree, and probably nod his head vigorously, if I were to say that, in his opinion, the Fujitsu UK broadband vehicle is superior to BT’s bid.”

Comment 52—It was open to North Yorkshire to choose the Fujitsu bid at the time. As they did not choose Fujitsu, it would be reasonable to ask North Yorkshire on what basis they chose BT. The answer is that BT’s was the best value for money solution given the funding that North Yorkshire had available.

Q106 (Mr Barclay)—“To be clear, the effect of reducing from 100% to 90% was to distort the competition in favour of the existing monopoly supplier, which had won every other bid.”

Comment 53—The target was not reduced from 100% to 90% therefore this statement and any resultant “effect” is false. As set out in our comments 3 and 5 above, there was no reduction from 100% to 90% and no distortion of competition in favour of any one party; neither was BT a monopoly supplier.

Q106/107 (Nicholas James)—“Correct—and, very importantly, FTTC. BDUK decided part of the way through this process that it would accept that anyone connected to FTTC ticked the NGA box. In effect, BT is going to get paid as though it had connected people to NGA when it has not.”

Comment 54—All three parts of this statement are false. (1) BDUK did not decide “part of the way” through the process to allow FTTC as an NGA technology. FTTC was identified as an NGA solution in the EC State aid guidelines for NGA before the BDUK process had even begun. FTTC delivers speeds of typically up to 76Mb/s, which is two to three times the speed threshold defined for NGA, so it qualifies as a relevant technology. (2) BDUK did not decide that “anyone connected to FTTC ticked the NGA box.” Only those end users who get an NGA speed are counted as getting an NGA speed. (3) BDUK does not pay BT for lines that get less than NGA speeds. The coverage obligation that BT is paid for only includes premises that do get NGA speeds.

Q108 (Mr Bacon)—“Descoping and paying more and getting less is something we are quite familiar with.”

Comment 55—This is an incorrect characterisation of the BDUK situation. In fact central government funding has reduced (from £530 million to £460 million) and coverage of superfast broadband will be ahead of target (on average 92% coverage according to the NAO, rather than the 90% target). We have gone much further in scope in many of the BDUK contracts we have won, in many instances well over 90%. Surrey is nearly 100% and West Sussex 98% to name but two. In addition in other similar contracts we have also increased the original scope eg in Cornwall where the scope increased from 84% to 92%.

Q116 (Mrs Hodge)—“A very high staff and management component—40% for an infrastructure project. It is unbelievable.”

Comment 56—Labour is inevitably a considerable proportion of the construction costs of a physical asset. The proportion of the deployment labour and project management costs (which does not solely relate to labour) is 41% when compared to build capex, or 37% when compared to total capex costs. BT does not understand what the Committee’s apparent concern is with the capitalisation of labour costs, since this labour is necessary to create and build the resultant network asset. This is very common in the construction and IT industry and the PAC are welcome to consult with our auditors on this matter. We are therefore unclear if it is the Committee’s view that they would prefer BT to make permanent staff redundant and instead to outsource the work to a third party thereby reducing the labour element? If so, the Committee should make this clear if this is their preference but it is something that BT would oppose.

Q120 (Mrs Hodge)—“You negotiated a premium for take-up risk. How much was that?”

Comment 57—We have provided further details of the project margin and the so-called take-up premium in a separate paper—see the attached Annex 1.

Q127 (Malcolm Corbett)—“The SMEs were excluded from the framework entirely from the outset.”

Comment 58—It is untrue to say that SMEs were excluded from the BDUK Framework. SMEs could participate and did participate. They have to have financial cover, as befits a risky contract, but they can be part of consortia.

Q127 (Mrs Hillier)—“Was there a requirement that consortia included small companies?”

Comment 59—The BDUK Framework provides for smaller companies to join consortia and it is encouraged however it is not compulsory. BT seeks to use the most cost effective suppliers for its services, however this typically involves national supply agreements for services such as civil contracts, fibre deployment etc. in order to keep costs down and enable our large scale deployments. These national level contractors then source local labour in the areas where they are working. For the BDUK areas we expect that local subcontractors would be considered as a first choice to be able to build the network in the timescales required, subject to availability, skills and capability.

The contracts we have with our suppliers will often utilise local companies to deliver services in a local area as it is more cost effective than transporting labour around the country, but this is typically done as part of a national or regional agreement due to the scale of the programme.

Q135 (Nicholas James)—“Doing the 10% becomes more expensive than if you had bolted into the 90%.”

Comment 60—This assertion misrepresents the realities of network economics. Communications networks become increasingly expensive to deploy as the dispersion of customers increases (or density of customers decreases). To install a fibre connection for 100 premises in a community is less expensive per premises than to install a fibre connection to one premise in an isolated location. The last 10% is more expensive than the first 90% because of the distances between customer premises. This remains the case whether the Government chooses to go to 100% of premises in one tender (as in Surrey) or to go to 90% of premises first and then final 10% later.

Q139 (Mrs Hodge)—“But what would your view be about the additional delay if there was a halt now?”

Comment 61—If the Department called a halt now to the BDUK process, and intended to achieve the same policy goal of extending fibre roll-out into the remaining BDUK areas, then it would be required to go through the following broad processes: designing a new scheme, gaining State aid approval for the new scheme, conducting a new procurement process (that complied with public procurement rules) and contracting with new winning providers. The experience of the BDUK process would suggest that this would be unlikely to be completed in less than two years.

Q146 (Mr Bebb)—“I have been involved in a number of community initiatives in my constituency, in order to identify whether they can get a rural grant to put in an independent system—for example, a wireless broadband system ... Each grant application has to be referred to BT for it to clarify whether it is in the 10%, so the answer that you have just given me makes me slightly concerned as to *whether the decision is yours*, or whether it is that of your partner in Wales, which is the Welsh Government, because their grant form is specific that the information as to whether they are in the 10% and are therefore excluded comes from BT.” [Emphasis added]

Comment 62—Whether an area is within the planned intervention area is a decision for the local body, in this case the Welsh Government, not BT. The decision is dictated by the commercial deployment plans of all network operators, irrespective of technology. If no operator has deployed or is planning to deploy in an area in the next three years, that area can be included in the overall intervention area. BT is then contracted to provide fibre broadband in the areas that the Local Body determines through the OMR and contract process. BT does not make the decision as to whether an area is in the footprint or not. It is a decision for the Local Body and a matter of what is dictated by the contract.

Q146 (Nicholas James)—“A necessary condition of approval is that Member States publish details of the proposed measure—ie the contract. That does not necessarily mean the financial details, but the mapping of it. It continues: ‘A publication on a central web page ... would ... ensure that such information is made available to all interested stakeholders.’ That is what the EU told us to do. If we just did that, it would solve most of the problems we are discussing. It is in the rules. We are not following the rules.”

Comment 63—The BDUK approach is fully compliant with the requirements of the EC State aid guidelines and the EC State aid clearance decision.

Q146 (Malcolm Corbett)—“The strong steer that you are giving here is around transparency over the roll-out plans and where the investment is going to be made and where it is not. If you were also to make a strong steer to say that we do not want to see other private sector or community initiatives being over-built with State funding, that would be extremely helpful, because it seems completely bonkers.”

Comment 64—BT strongly agrees that private sector funding should not be overbuilt by State funding (local or central). That is the intention and practice of the BDUK process, where all actual and intended commercial deployments are declared in the open market review process before the intervention area is defined. Where community projects are themselves government funded however it also important to ensure that State funds are not spent twice.

Q151 (Ms McTaggart)—“How many thousand households are so far away that what they are getting is not SFBB in any form?”

Comment 65—BT has provided separate written information on this question to the Committee in Annex 1.

Q152–3 (Mr Bacon)—“How much of the £356 million is cash as opposed to allocation of common costs or capitalised labour?”

Comment 66—BT has provided separate written information on this question to the Committee—see the attached Annex 1.

Q156 (Mrs Hodge/Sean Williams)—“How much of it [the £356 million of capital investment noted by the NAO] is investment?”

Comment 67—BT has provided separate written information on this question to the Committee—see the attached Annex 1.

Q159 (Mr Heaton-Harris)—“At this present moment in time BT is marketing a BT Sport thing where you take-up broadband which is remarkably cheap...You would have heard the rumours as much as everyone in this room that there is some form of substitution process going on and that perhaps, in some indirect manner, the delay in the delivery of rural broadband is related in some way to BT’s ability to provide something that costs a lot of money to its customers for free. I am keen for you just to say, No, that is completely incorrect.”

Comment 68—As stated at the hearing, such rumours are completely incorrect.

BT is a new entrant into the pay TV sports market. It faces an entrenched incumbent with an 80% market share, BSkyB. It has invested £1bn in sports content rights, TV platform and network capabilities and sales and service operations to enter the pay TV sports market. BT will be earning revenues from this investment by marketing it on the satellite platform (for a monthly subscription of either £12 or £15 a month) and to its actual and potential broadband customers, including fibre broadband customers, who will be able to receive it at no charge in addition to their broadband subscriptions. By increasing broadband subscriptions to BT, by encouraging BT broadband customers to stay with BT, by generating new customer relationships and by generating revenues from satellite subscribers, BT will monetise its investments in pay TV sports.

An important point to draw out of these facts is that BT Sport is available to all its broadband customers, not just its superfast broadband customers. So the investment is not related to superfast broadband specifically. If all our BT Sport customers subscribed to copper broadband, it would have no effect on superfast broadband take-up. We hope that BT Sport investment will indeed increase take-up of superfast broadband, including in rural areas.

Driving take-up of superfast broadband is in any event a good thing from a public policy perspective. Indeed retail level take-up is a contractual obligation under the BDUK framework. Clearly the Government does not want to invest in infrastructure and not have it used. We believe that the promotion of content, and increased competition in the pay TV market, is a further positive contribution to the success of the BDUK scheme.

As explained above, BT expects to be committed to over £700m of investment to support the BDUK scheme, and £800m if Northern Ireland and Cornwall are also included. In addition there is a potential for BT's spend to further increase to £1bn to match the remaining government allocation of £250m (ie to align with the original £830m central government announcement) an investment that is not expected to achieve pay-back for 15 years. The BT Sport investment also has a long pay-back. So, far from the BDUK investment and the BT Sport investment subsidising each other, the opposite is the case: both these large simultaneous investments compete with each other as calls on BT shareholders' funds.

Q162 (Dido Harding)—"You [BT] are unwilling to wholesale it [BT Sport] to other people."

Comment 69—This statement is not correct. BT has made clear publicly that it is willing to wholesale BT Sport to other communications providers, and has been in dialogue with a number of them, including TalkTalk, Virgin Media and BskyB and BT has just announced the conclusion of an agreement to wholesale BT sport with Virgin Media.⁴⁰ Indeed BT has taken a Competition Act complaint to Ofcom concerning the terms that BskyB has been seeking to impose on supply of BT Sport in return for the supply of Sky Sports 1 and 2 on Youview.

Q163-4 (Dido Harding)—"You can only get BT Sport on your television, as opposed to on your computer, if you take Infinity or have a Sky dish. That directly excludes my customers ... You can't watch BT Sport as a TalkTalk customer."

Comment 70—This statement is internally inconsistent. The witness acknowledges that customers can get BT Sport who have a satellite dish, which includes TalkTalk broadband customers who have a satellite dish. So it is not correct to say that they can't get BT Sport as a TalkTalk customer of TalkTalk phone and broadband services. There is only one limited sense in which the statement is valid. As BT and TalkTalk have not agreed the terms of wholesale supply, BT Sport is not available to TalkTalk TV customers if they are not also satellite subscribers.

Customers who are not subscribers to BT Retail's superfast (fibre) broadband product can get BT Sport. In fact almost all BT broadband customers can get BT Sport, even if they get only standard (copper) broadband.

Q164 (Dido Harding)—"Several hundred million pounds have been invested in building BT Sport have to be linked to the fact that BT is rebuilding its monopoly in superfast broadband."

Comment 71—As explained in comment 70 above, BT's investment in BT Sport is an investment for all its broadband customers, not just its superfast broadband customers. Yes, of course BT is making investments in its propositions to attract customers to its services. So are TalkTalk and Sky and all other competitors. BT has never had a monopoly in superfast broadband and no, BT is not building (or rebuilding) its monopoly in superfast broadband. As noted by the Ofcom witness, Stuart McIntosh later in the PAC hearing,⁴¹ BT has a smaller market share than Virgin Media in superfast broadband and only at the end of 2012 achieved a network footprint larger than Virgin Media's. Our Retail superfast broadband customer base is 1.5 million subscribers. Virgin Media's is 2.5 million subscribers. In fact as the witness notes elsewhere in her evidence to the PAC, the UK's is amongst the most competitive broadband markets in the world, with the market leader, BT, having a share of only about 30%, which is lower than the market shares of incumbents in other European countries.

Q166 (Mrs Hodge)—"BDUK research shows that the roll-out of SFBB by postcode declines as the percentage of businesses in the postcode rises."

Comment 72—We are not familiar with the research referred to in this question. However, we would make the following comments:

- BT has a single deployment model, which seeks to estimate likely take-up and revenues, likely costs of deployment, and to identify which areas can sustain a commercial return for fibre investment. This is the same model that is used for its own commercial deployment and for BDUK contracts.
- Significant factors in determining whether the business case for fibre deployment in an area is commercially viable include a) the number of end-subscribers attached to the new fibre cabinets being installed, and b) whether the copper network needs to be re-engineered to provide SFBB service.
- Postcodes with a high degree of business users tend to be in urban areas, such as town centres, or on the fringes of urban areas, such as in business and retail parks.
- These areas can suffer from the problems of low numbers of subscribers per cabinet and copper re-engineering requirements.

Q168 (Mrs Hodge)—"So you have a profitable business in leased lines and you are deliberately failing to meet the economic objective of this whole programme, which is to improve the efficiency of our businesses, by choosing to put in superfast broadband in those postcode areas that have fewer businesses so that you can hang on to that profitable leased lines business. That is just awful."

⁴⁰ <http://www.btplc.com/News/Articles/ShowArticle.cfm?ArticleID=45262846-58D9-4D23-9DA8-3FB9234B29AB>

⁴¹ In response to Q 345 from the Chair

Comment 73—This does not reflect the reality of the situation and BT’s investment model. BT has a single model for deciding where to roll-out its superfast broadband network. This takes account of: (a) the revenue opportunities—where end-users are most likely to be willing to subscribe—and (b) the cost expectations—how much it is likely to cost to deploy the fibre network in each locality. BT has then chosen to push its commercial fibre deployment to two thirds of the country, 19 million premises, including business premises, where it is most likely to be able to achieve a commercial return. The presence or absence of leased line networks is not a factor that has any bearing on the deployment model. The model contains no variable related to the presence or absence of leased lines. The model is incapable of taking this factor into account. The same model applies in BDUK programmes. Indeed we are contractually committed to consistency in modelling between our commercial programme and the BDUK programme.

The leased lines market is a mature and viable commercial market. It would be contrary to State aid rules to distort commercially viable markets with State subsidised infrastructure.

Q172–3 (Mrs Hodge)—“We have a new housing development, with I think about 400 homes on it at the moment, which will probably be about 1,000 by the time it is all developed, on an old University of East London site, and the developer-contractor contracted with BT to provide the broadband, but you only provided it at 2 megabits, which is far too slow in a brand new development in our capital city ... [BT’s] response was that you would only put it in if you got a subsidy. How on earth can you justify that as a credible way of using public money to fill the pockets of your shareholders?”

Comment 74—BT has responded separately on the subject of the particular development scheme in the Chair’s constituency. However, the general point is that the model for commercial deployment of superfast broadband infrastructure seeks to determine which local areas will be commercially viable, by assessing the likely willingness of potential customers to subscribe to the service and the costs of deploying the network. As a result there are some city areas where the deployment of superfast broadband is not yet viable. That is why the Government has a second scheme designed to encourage further superfast broadband roll-out in cities, separate from the BDUK scheme.

Q178 (Mrs Hodge)—“If you go for 90%, you miss the very remote farmers DEFRA is insisting that all rural payments are now paid online. There will be no other way of claiming them except online. The way you have chosen to exploit £1.2 billion of public subsidy is such that actually you are not providing the service, and farmers, in this instance, will not be able to access the subsidies they need.”

Comment 75—The Chair is perhaps forgetting the second objective of the BDUK scheme which is to ensure that practically all premises receive at least 2Mb/s broadband. Once all the BDUK schemes have been deployed not only will the BDUK areas get superfast broadband coverage of over 24Mb/s to over 92% of the country on average, but also the number of premises receiving a broadband service of less than 2Mb/s will be less than 2%. In each BDUK contract signed to date a proportion of the funds, agreed with the Local Body, is focused on deploying standard broadband, ie not NGA, solutions that will deliver a minimum 2Mb/s service to these last remaining customers who cannot receive a 2Mb/s service under other provisions. Consequently, one of the benefits of the BDUK scheme is that even remote farmers will be able to get a functional broadband service sufficient to make their subsidy payments on line, just as all customers will for their needs.

Q232 (Mrs Hodge)—“Not when they charge such a lot for the wholesale cost, unregulated by Ofcom.”

Comment 76—The Chair is mistaken. The wholesale fibre product is not unregulated. As stated above (see comment 36, 29 and others above), BT’s wholesale fibre access product (GEA) is highly regulated to the demanding EOI standard. We have an obligation to supply GEA, we have an obligation to supply on non-discriminatory terms, and the same terms for all Openreach’s customers, whether BT or any other communications provider. The only aspect of regulation that has not so far been applied is price regulation. This is because Ofcom had no basis for setting regulated prices at the time of the launch of the new fibre product and did not want to discourage investment in new infrastructure. Ofcom has recently confirmed its view that GEA should not be price regulated for the period of the next market review, for the same reasons.

Q234 (Mrs Hodge)—“And BT is paying £200 million less.”

Comment 77—The Chair is mistaken. As we said in comment 21 above our commitment at the beginning of this process was that we would put up to a further £1 billion (further to the £2.5 billion of costs we are incurring in our own commercial deployment) to match an expected £830 million of central government money, including Cornwall and Northern Ireland, a ratio of 120% of central government contribution. BDUK has allocated only £462 million of its funding to Local Bodies, but we will have put in over £700 million to match it, a ratio of 150% of central government funding. In other words our contribution is greater than expected not less.

Q249 (Mr Swales)—“Because of the way it is now being measured in BT’s favour, cabinets that might be a mile from somebody’s house will be counted as if you have put broadband into all the houses in that area, at least that was how I understood the previous witness.”

Comment 78—The statement from the previous witness referred to here is false. As we stated in our comment 8 the fact that a minority of lines on a particular enabled cabinet will not receive 24Mb/s is not relevant to achieving the NGA coverage targets: lines that are too long and therefore not capable of receiving

24Mb/s are not included in the coverage targets that BT is contractually committed to deliver. They do not count towards satisfying the NGA coverage requirements. Only those lines that do achieve 24Mb/s or more count towards the NGA coverage target. The increases in broadband speeds on long lines achieving less than 24Mb/s are an incidental benefit of the investment and only go towards achieving the second speed/coverage objective of the rural broadband programme, namely that of ensuring that all premises receive at least 2Mb/s.

Q252 (Mr Bebb)—“Yet local authorities are paying 48% more than was originally estimated. A 48% added contribution from local authorities for 2% more households does not stack up.”

Comment 79—Local Bodies have chosen to invest more money to take superfast broadband roll-out further. This is a success of the BDUK scheme, which sought to engage Local Bodies and build their enthusiasm for fibre roll-out in their areas. As a result the footprint expected to be achieved by BDUK has increased.

It is incorrect to say that BT is paying less. As explained in response to the same point above, BT is expecting to be committed to over £700 million of costs to rollout BDUK networks, relative to £460 million of central government funding. This increases to £800 million if Northern Ireland and Cornwall are also included. In addition there is a potential for BT's spend to further increase to £1 billion to match the remaining government allocation of £250 million (ie to align with the original £830 million central government announcement) an investment that is not expected to achieve pay-back for 15 years. In fact therefore the ratio of our contribution to central government contribution is higher than expected.

The total impact of BDUK intervention is to increase SFBB coverage from about 76% to the relevant areas to about 92%, a 16% increase. So a 2% increase in the national footprint, is on average an increase in the BDUK element of footprint from 14% to 16%, ie approximately a 14.5% increase in premises to be covered by the BDUK programme. As stated in the NAO report⁴² this should be compared with an increase in the total public funding of 24%. This is further confirmed by the witness, Jonathan Stephens, who says it is not surprising at all that the increase in funding will be greater than the increase in coverage, because by definition the incremental coverage will be more expensive than the original footprint. Each additional 1% of coverage will cost more than the average in deed at the extreme, to move from 99% to 100% could cost many times more than moving from 90% to 91% depending on local geography and conditions etc. This ratio 14.5% increase in footprint for 24% increase in public funding (plus an increase in BT funding) is far from unreasonable and does “stack up.”

Q256 (Mr Bebb)—“Yes, we have heard in prior evidence that there have been examples of local authorities being bullied by your main supplier on these contracts.”

Comment 80—BT takes accusations of bullying very seriously and we strenuously deny any assertion that BT has “bullied” local authorities. We have certainly seen no evidence to back up this assertion.

Q276 (Mr Swales)—“The key evidence is that, because that 90% figure appeared, it totally favoured BT, who were able to get to 90%.”

Comment 81—The Committee member, Mr Swales, has been misled in each of these two points. Firstly, as we have explained in comments 3 and 5 above, there was never any change to the target that resulted in the figure of 90% “appearing” it was always part of the BDUK Delivery Model published in March 2011. Secondly, any bidder who was able to get to the targets in the BDUK Delivery Model was free to bid and there is no evidence that BDUK Delivery Model or targets favoured BT.

Q286 (Mr Bacon)—“It might be of benefit to BT, the monopoly supplier, but why would that be of benefit to the taxpayer?”

and

Q339 (Mr Bacon)—“That is part of the way in which BT are using their monopoly advantage.”

and

Q340 (Mr Bacon)—“Hugely advantageous to BT, to the detriment of everybody else.”

Comment 82—As explained in previous comments, BT is not a monopoly supplier and is not dominant in the market for broadband or superfast broadband which is the subject of the BDUK programme.

Q349 (Mrs Hodge)—“The accusations we have heard today from previous witnesses ... is that the way BT manipulates access to its infrastructure prevents the suppliers of the infrastructure from entering the market.”

Comment 83—These accusations from previous witnesses are false. As we have stated in previous comments in particular comments 8 and, 9.

BT Group

13 August 2013

⁴² Figure 14 of the NAO report, page 27

BT RESPONSE ON SPECIFIC ITEMS TO PAC

During the hearing of the Public Accounts Committee on 18th July, Sean Williams agreed to provide a number of specific items of information relating to details of risk premiums, coverage and investment by BT in a further written response to the committee's questions. These responses are provided below. BT will also be providing a full written response to various other issues raised during the hearing in due course, but we trust this information fulfils the specific commitments that we made at the hearing.

ISSUE 1—"TAKE-UP PREMIUM" (Q 119, 120 & 121)

As BT does not know where the term "take-up premium" came from, we have responded below on two possible interpretations. The first based on the phrase as used by Mike Kiely, a consultant previously with BDUK, and the second based on the claw back mechanism and how additional revenue associated with additional take-up beyond our bid assumptions is treated.

To address the first interpretation, under the Framework and Call-Off contracts there are four types of milestones, which have a number of associated conditions/criteria to be met and verified by the Local Authority before BT can claim a milestone payment and thus any government funding to offset costs incurred to achieve that milestone. These are:

- Milestone 0—Survey and Detailed Design Completion.
- Milestone 1—Network Build:
 - Exchange.
 - Fibre spine.
 - 1st cabinet connected.
- Milestone 2—Availability of Wholesale Access Products and Services:
 - Cabinets and structures with associated total homes passed.
- Milestone 3—End User Take Up of the services provided.

A retention of 0% to 10% of the total external funding (Local Body decides the percentage) due under the contract is withheld by the Local Authority until such time that a certain level of take-up is achieved. The retention is only paid to the Supplier on achievement of that level (the level of take up is set at 6% on BDUK contracts for the retention to be paid).

The reference to a "take-up premium" therefore could be in relation to Milestone 3 as it involves a payment to BT once a certain take-up is achieved. It is incorrect to describe this as a "take-up premium", however, as it is merely the payment of costs incurred that have been agreed under the contract and withheld pending achievement of the set level of take-up. Although the contract clearly defines this as a retention for achievement of take up, we believe Mr Kiely may have confused this as an additional payment for achieving a certain take-up. This is not the case. BT does not receive a premium for reaching this measure; we merely receive the agreed retained payment once the take up threshold is met. The funding for this retention is linked to the capital expenditure incurred. If the take-up is not achieved, or if there is a delay on timescales, BT's financial payback will be affected. BT does not charge any premium on the capital costs it incurs; we will claim only the cost defined as eligible Capital Expenditure as defined in the contract. These costs will be fully supported with auditable records of timesheets, invoices, receipts and also evidence we have paid our own supply chain.

The second possible reference to a take-up premium is in relation to gain share on take-up above the modelled amount. The Framework contract agreed between BDUK and Framework suppliers includes a "gain share" mechanism as part of the claw back arrangements of State aid funding in the event that actual take-up of the superfast services within the BDUK areas is more than the business case forecast. In gap-funding models, it is necessary to calculate not only the costs of building and running the network, but also the expected revenues and costs that will be generated by the resultant network investment. All the revenues are set off against the costs in the business case model. The difference between what a normal commercial business case would support for investment and the investment required to achieve the government's policy objective is "the gap" that needs to be funded from the public purse. It is therefore essential that an estimate of take-up be included in the calculations as a foundation for estimating future revenues.

As explained in our answers on the day of the PAC hearing BT has used the figure of 20% take-up of superfast services in its commercial business case and in all the BDUK bid cases so far. This assumption not only maintains consistency with our commercial case since the beginning of our investment programme (which is a commitment we gave as part of the value-for-money protections under the Framework), but one that also maintains consistency with experience of take-up of superfast broadband services in other markets in Europe and elsewhere that was supported by independent research conducted by the Broadband Stakeholders Group.⁴³ The view at the time of BT's commercial investment and at the time of the Framework negotiations was that 20% take-up of a premium price superfast service (as fibre based broadband is compared to current ADSL broadband) was realistic and consistent with our commercial case and external market evidence.

⁴³ <http://www.broadbanduk.org/wp-content/uploads/2012/11/superfastbroadband.pdf>

In the event that this 20% take-up figure is exceeded, revenues will be greater than expected. The additional EBITDA (Earnings before Interest, Tax, Depreciation and Amortisation) associated with this additional revenue is then calculated. This additional EBITDA will not have been included in the original gap funding calculation. In order to prevent over-payment relative to the gap funding calculation, the additional EBITDA is returned back to the project investors in the same ratio as the project's investment ratio. For example, if BT had provided 30% of the project funding, then the government would get 70% of the additional EBITDA. This additional funding is available to Local Bodies to push the fibre coverage further for the same amount of funding if they should so choose. For example, instead of delivering a proposed 90% coverage, the additional profit from any additional take-up can be used to take coverage above 90%. In the event that the Local Body chooses not to spend the money on extra coverage, then the funds will be returned to the Local Body with interest at the end of the contract term.

If this is the correct interpretation of the "take-up premium" to which you refer, then the take-up premium will vary from county to county under the terms of each contract but will be calculated on the basis of a fixed sum per subscriber, £x annum per additional connection over 20% (typically in the range of £44 to £80 per annum), and then this amount will be shared between BT and the project on the same basis as the original investment (which varies from contract to contract). The resultant funds will then be available for further investment in additional coverage.

ISSUE 2—COVERAGE TARGET AND NUMBER OF CUSTOMERS IN BDUK AREAS THAT WILL NOT RECEIVE 24MB/S SERVICE AT END OF CONTRACT (Q147–151)

Each Local Body tender has an objective to achieve 90% coverage of superfast broadband (over 24Mb/s) service across the entire county.

Contracts funded by State aid are only allowed to intervene in areas where there is no commercial provider either delivering these services today or expected to deliver these services within three years. The Local Body, prior to issuing the tender to the market, conducts a review of the current and planned commercial coverage in their area. This is known as the Open Market Review (OMR) and is a fundamental requirement of the State aid process. This review defines the areas where major commercial players, such as BT and Virgin, plus any other commercial networks, including community schemes such as B4RN, are planning on providing services over 24Mb/s within three years. As a result the planned commercial coverage of a particular county will be defined at the start of the tender process and thus the additional coverage required in order to reach an overall county coverage level of 90% will be calculated.

The exact percentage of premises that will need to be addressed in order to hit an overall 90% county coverage target will vary from contract to contract depending on the extent of commercial coverage in that county. In addition, the money available in each county and the cost of delivering the required percentage coverage to hit the target will vary such that in some counties (eg Highlands & Islands) there may not be sufficient money to hit the 90% target, whereas in others the funding will go significantly beyond 90% (eg 99% in Surrey).

The particular solution adopted by BT, based predominantly on fibre to the cabinet technology, will result in some lines on publicly funded cabinets receiving less than 24Mb/s. This typically happens in cases when premises are a relatively long distance from the cabinet. Such premises will typically receive a significant uplift in the broadband speeds, but not all the way to the 24Mb/s threshold.

However, these lines (receiving less than 24Mb/s) will not count towards the coverage target and will not impact the committed delivery target within the intervention area. The contracts specify that the Supplier must deliver the required number of premises at 24Mb/s and above to meet the contractual target, even though some lines on a particular cabinet may not meet the 24Mb/s target. The lines that get an uplift in speed but not to 24Mb/s are an ancillary benefit, not counting towards the 24Mb/s target, but counting towards the second objective of ensuring that all lines receive at least 2Mb/s.

The precise number of such lines will depend on the size of the intervention area and target coverage required in that intervention area to hit 90% overall. However since none of these lines will receive a 24Mb/s service they will not be counted towards achievement of the 90% target ie to achieve the contractual coverage target in the intervention area BT WILL NOT count sub 24Mb/s lines towards the target.

With regards to actual numbers of lines receiving less than 24Mb/s in a typical intervention area, we use Devon & Somerset as an example. The OMR process for Devon & Somerset showed that there were some 967,000 premises in total in the county and 607,000 of these are planned to be covered by commercial providers. This leaves 360,000 premises without a commercial NGA service and thus part of the BDUK contract. 90% of 967,000 is 870,300 therefore it will be necessary to provide 24Mb/s services to an additional 263,000 premises on top of the 607,000 commercial coverage to hit the 90% target. Any long lines on an FTTC cabinet delivered under the BDUK programme that do not deliver 24Mb/s will not count towards achievement of this target. Therefore when the 90% target has been hit, there will be 96,700 premises without a 24Mb/s service. This figure will include both those premises on long lines on NGA cabinets receiving less than 24Mb/s and those where no NGA build has been made. Currently BT plans to exceed the 90% target in Devon & Somerset with the current funding.

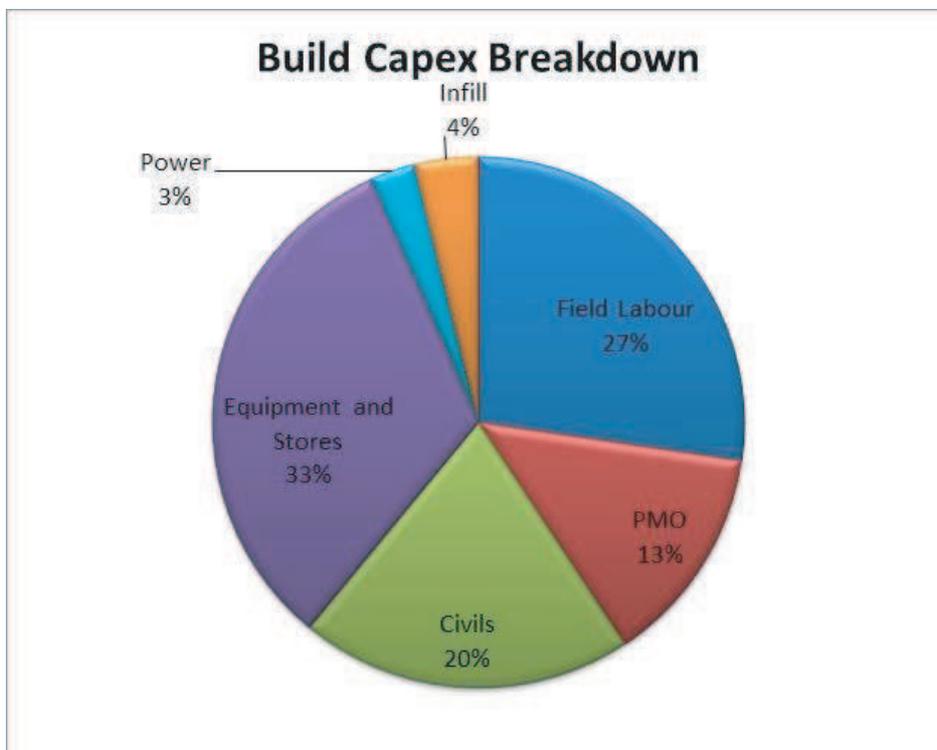
ISSUE 3—EXPLANATION OF THE “CASH” COMMITMENT BY BT VS. CAPITALISED LABOUR COSTS

It is not quite clear to BT what the committee’s concern in relation to cash costs was, and what distinction they were trying to make.

The £356 million referred to in figure 14 of the NAO report represents the NAO’s latest assessment, based on the BDUK projects to date, of the capital costs BT will make. As we have said elsewhere in our responses, the NAO have not recognised any costs incurred by BT other than our capital costs, even though BT will be spending considerable amounts on equipping the network, connecting customers to it and running and operating the network. As a result the figure of £356 million represents just the pure capital equipment spend by BT.

This amount does not include any apportioned common costs. All the costs are cash costs in the sense that it is money spent that reduces the cash of BT Group, whether paid to suppliers, external contractors or internal labour force.

This amount does include capitalised labour costs, both the labour costs of our suppliers and our own labour costs. Obviously these labour costs are only those relate to the installation and commissioning of the capital equipment, eg installing a cabinet in the street, for the investment in the BDUK programme. The chart below details the % by cost category:

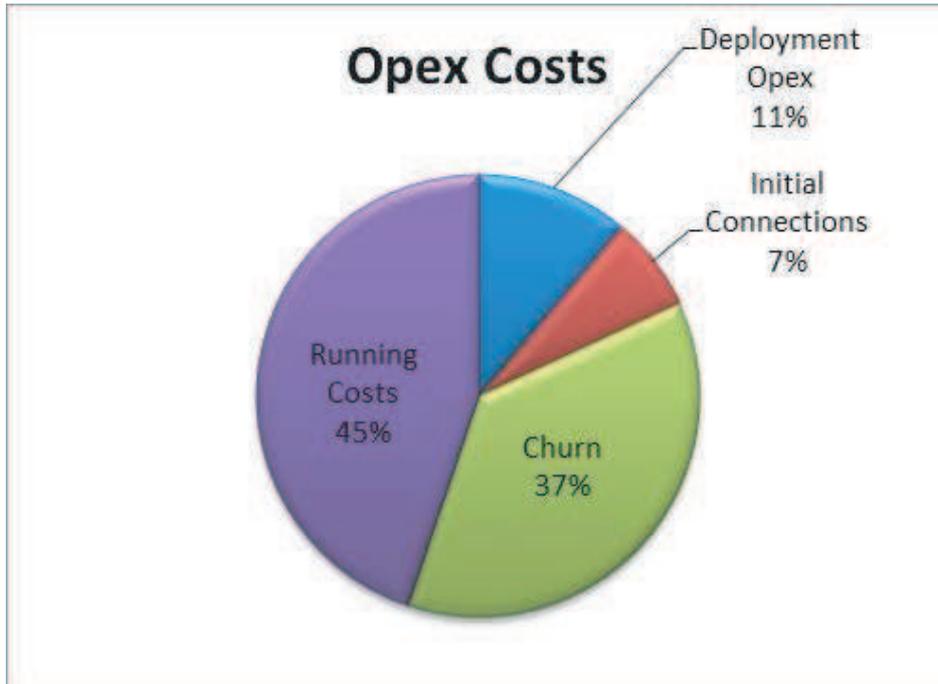


| | |
|----------------------------|---|
| Equipment and Stores | Headend, fibre spine, poles, ducting, cabling, cabinets, distribution boxes, manifolds, household equipment |
| Field Labour | Openreach Engineering to deliver the network equipment |
| Civils | External contractors to deliver to deliver the network equipment |
| Programme Management (PMO) | Programme and Contract Management (including set up costs) and Commissioning |
| Power | Cost to power companies for cabinet power supply |
| Infill | Satellite and BET costs supporting Basic Broadband requirements |

In addition to these pure capex costs, BT expects to spend more than an additional £300 million on equipping, running and maintaining the network through the 10 year lifetime of these contracts, all of which represents cash to the business that could have been utilised elsewhere if this network had not been built.

These are incurred during the deployment phase on the contract and post deployment, particularly in the early years before full take up where revenues do not offset running costs.

The chart below details the % by cost category:



| | |
|---------------------|--|
| Deployment Opex | Costs associated with procurement of the contracts and supporting the contract inlife such as finance, legal and marketing (where applicable) costs. |
| Initial Connections | Non capitalisable costs relating to connecting the initial 20% take-up |
| Churn | Non capitalisable costs relating to churn within the customer base. |
| Running Costs | Costs associated with running the network and keeping the equipment up to date; <ul style="list-style-type: none"> — Power — Maintenance — Way leaves — Call centre — Network operations Training & kitting — Network refreshment/enhancement — Inflation |

In total for BDUK contracts, BT expects to be committed to over £700 million of investment, matching £460 million of BDUK funding. When we add in the costs of the other publicly funded projects in Northern Ireland and Cornwall, the total cost to BT is expected to be in excess of £800 million.