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Broadband Delivery UK (BDUK)

2016 National Broadband Scheme for the UK

Guidance: Wholesale Access and Pricing

1. Introduction

- 1.1. This BDUK document provides guidance to suppliers, implementing bodies and other stakeholders on the requirement and application of price controls in broadband projects needed to comply with the relevant State aid guidelines applying to broadband interventions. This guidance is applicable to all projects approved under the 2016 National Broadband Scheme (the 2016 NBS).
- 1.2. As the 2016 NBS is an umbrella state aid scheme, the projects submitted by Implementing Bodies to BDUK's National Competence Centre for State aid approval will need to demonstrate that they have incorporated a mechanism to benchmark and control prices of products offered by the supplier in receipt of the aid in their contract with that successful supplier.
- 1.3. Such controls should ensure that a supplier of NGA services is neither able to exploit its monopoly position to charge too much nor undercut other providers (e.g. of basic broadband services) by charging too little, relative to relevant benchmarks.
- 1.4. The approach to benchmarking set out in this document has been developed by BDUK through its implementation of the 2016 NBS and in light of discussions with the European Commission (the Commission).
- 1.5. Implementing bodies must identify suitable benchmarks for all the specified wholesale access products to be offered by the operator of the subsidised infrastructure.¹ For the purposes of this guidance, "subsidised infrastructure"

¹ For a list of specified wholesale access products, see Guidance: Wholesale Open Access Network Requirements.

refers to both infrastructure subsidised directly and to existing infrastructure used in the deployment of the subsidised services in the intervention area.

- 1.6. Wholesale access products will include both broadband products and non-broadband products (e.g. voice services or business connectivity/leased lines). The appropriate benchmark for those products must therefore take into account the nature of the wholesale access product, in addition to the point of wholesale access to the subsidised infrastructure. The appropriate wholesale access point is likely to vary depending on factors such as geography and the technology involved. Therefore, a benchmarking mechanism may involve a number of price ranges.
- 1.7. The rules applicable to the benchmarking of non-broadband products are broadly similar to the rules applicable to broadband products. However, additional conditions apply (see paragraphs 4.11 – 4.14 below).
- 1.8. Implementing bodies are required to ensure that the benchmarking requirement detailed in this note is adhered to for the duration of their contracts with successful suppliers.

2. Requirement for price control mechanism

- 2.1. The inclusion of a price control mechanism is a requirement of the 2016 NBS.² As such, BDUK must ensure that this requirement is satisfied by all implementing bodies who wish to rely on the scheme.
- 2.2. The purpose of the benchmarking exercise is explained at paragraph 78(h) of the Commission's *Broadband Guidelines*:

“Benchmarking is an important tool for ensuring that the aid granted will serve to replicate market conditions like those prevailing in other competitive broadband markets. Wholesale access price, should be based on the pricing principles set by the NRA and on benchmarks and should take into account the aid received by the network operator. For the benchmark, the average published wholesale prices that prevail in other comparable, more competitive areas of the country or the Union shall be taken or, in the absence of such published prices, prices already set or approved by the NRA for the markets and services concerned. If there are no published or regulated prices available for certain wholesale access products to benchmark against, the pricing should follow the principles of cost orientation pursuant to the methodology established in accordance with the sectorial regulatory framework”.

- 2.3. The Commission's guidance on the price benchmarking exercise has two main objectives:
 - (a) To ensure that public funds are used in a manner that minimises distortion to a commercially functioning market;

² European Commission, SA. 40720 (2016/N) – National Broadband Scheme for the UK for 2016-2020, section 3.19 at http://ec.europa.eu/competition/state_aid/cases/263954/263954_1760328_135_4.pdf

- (b) To ensure that wholesale access to the publicly funded service is effective, in particular ensuring that it replicates the prevailing commercial conditions.

2016 NBS Requirement

- 2.4. BDUK will require all implementing bodies seeking to rely on the 2016 NBS to include a benchmarking pricing mechanism in their contract with the successful supplier. This mechanism, including the benchmarking criteria, should be set out clearly in the first instance in the tender documents issued to tenderers.
- 2.5. Such a mechanism must set out the framework applicable to the specified wholesale access products (see Open Access Wholesale Requirements guidance for further detail). These products must be made available for any electronic communications purpose (including broadband, voice services, and business connectivity).
- 2.6. Implementing bodies will need to identify appropriate NGA broadband and basic broadband benchmarks. Wholesale access prices should then be constrained with reference to those benchmark prices.
- 2.7. In most of the areas where broadband projects under the 2016 NBS are planned, the commercial market has already delivered basic broadband services and/or services in other markets. Publically funded NGA broadband services will therefore compete with these existing commercially funded basic broadband services.
- 2.8. In order to minimise distortions of competition, it is essential that the publicly funded services are not provided at a price which is “too low” compared with the likely outcome in a commercially driven market. One way to achieve this is to require the prices for publicly funded services to not be lower than commercial benchmarks for comparable services in more competitive/commercial areas (unless objectively justified³). In practice this will mean that the minimum price for publicly funded NGA services will usually be set by reference to the price of comparable services which are being provided by the commercial market in other areas.⁴
- 2.9. Such an approach is consistent with the Commission’s Broadband Guidelines, as it aims to minimise potential distortions by ensuring that prices for publicly funded services are not set at a lower level than those that prevail in other comparable, more competitive areas (unless objectively justifiable). It will also ensure that the aid granted replicates market conditions like those prevailing in other competitive broadband markets.
- 2.10. There is a presumption that all products shall have a floor price equal to that of benchmark products. There is also a presumption that all products shall

³ BDUK understands from the Commission that it can be acceptable under the Broadband Guidelines to price lower than the price currently imposed on the Significant Market Power (SMP) operator under the applicable regulatory framework. BDUK’s approach to benchmarking has been developed in this light.

⁴ SA. 40720 (2016/N) – National Broadband Scheme for the UK for 2016-2020, paragraph 138

have a ceiling price equal to a set level (i.e. [X%]) above that of the benchmark products (to be determined in the course of the tender process), unless the supplier can demonstrate that such prices are necessary for a sustainable business model and that this will not lead to the customer being overcharged. In the case of non-broadband products (i.e. secondary to the market that is being targeted), there are not expected to be any circumstances that would justify variation below benchmarks.

- 2.11. The purpose of the ceiling is so that access pricing facilitates a sustainable business model but no higher, such as to not limit access to services nor to minimise market distortion. For example, if the price was allowed to be set at a level significantly in excess of comparable competitive markets without objective justification, it may unnecessarily limit access to superfast broadband services if consumers are ultimately unwilling to pay. Setting a ceiling will also ensure that the access to publicly funded assets will replicate the prevailing commercial conditions in other competitive broadband markets. In most commercial models this is likely to be self-regulating due to the price elasticity of demand for superfast broadband.

3. **BDUK's recommended approach to benchmarking**

- 3.1. The 2016 NBS sets out the following approach to price benchmarking, which is consistent with the guidance issued under the 2012 NBS Decision:
- (a) Every wholesale access product ("product") made available under the intervention will be under benchmark controls;
 - (b) There will be a presumption that all products shall have a floor price equal to that of benchmark wholesale access products in commercial areas with similar characteristics ("benchmark products");
 - (c) There will be a presumption that all products shall have a ceiling price equal to a set level (i.e. [X%]) above that of the benchmark products (to be determined in the course of the tender process), unless the supplier can demonstrate that such prices are necessary for a sustainable business model and that this will not lead to the customer being overcharged (see further (e) below);
 - (e) There may be limited variation below and above the benchmark if well justified. Such justification would need to incorporate:
 - (i) Support for the need for the variation in price, e.g. low population density, scattered villages, difficult clustering and associated failure to attract internet service providers (ISPs);
 - (ii) Demonstration that alternative commercial mechanisms have been considered first;

The variation in price is limited in time, e.g. until establishment of first major ISP, until a set number of years into the contract (to be determined in the course of the tender process), or until there is any

significant change in the supplier's ability to attract users on to the network;

- (f) BDUK will facilitate implementing bodies to benchmark suppliers' actual prices annually against industry data (supported by Ofcom as described below). Supplier actual prices will be subject to a degree of tolerance against the data point;
- (g) Where there is clear divergence against the benchmark, the supplier is required to bring its pricing back in line, or otherwise the implementing body will escalate the matter to BDUK as the National Competence Centre, as a possible breach of State aid rules.

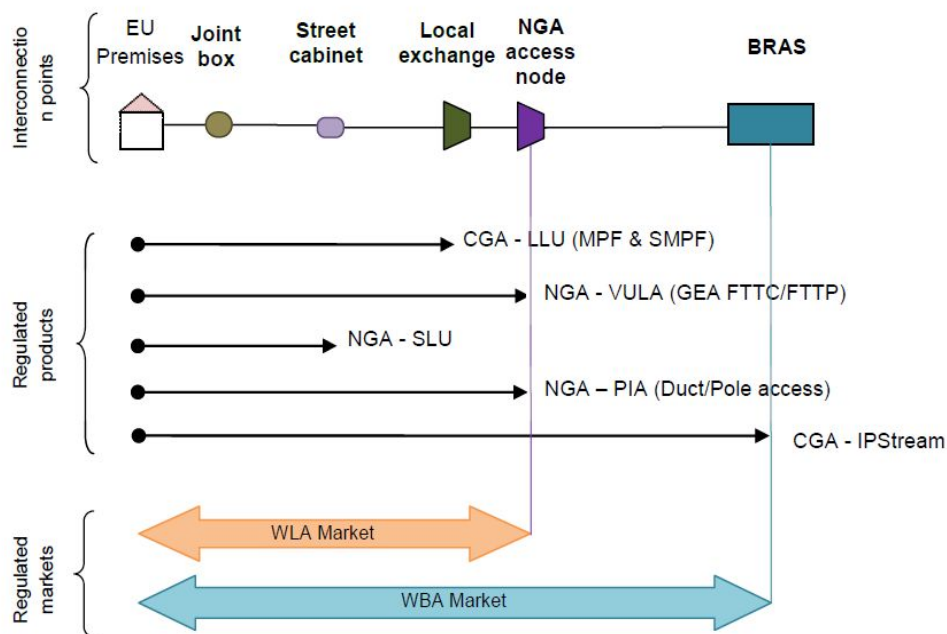
3.2. BDUK recognises that the detailed application of these benchmarking principles will need to be conducted on a case by case basis by implementing bodies due to the potential variability in approaches to the delivery of NGA broadband by different bidders (e.g. different access points, inclusion of non-broadband services etc). To that end BDUK will be on hand to offer support and guidance. BDUK will also seek to update this guidance note as implementing broadband projects begin rolling out to ensure lessons are shared with other implementing bodies and stakeholders. BDUK may also seek technical advice from Ofcom where appropriate should novel or different benchmarking mechanisms be proposed.

4. Identifying appropriate benchmark products

- 4.1. A key part of the benchmarking mechanism is identifying appropriate benchmark products. Appropriate benchmark products will be a factor of both the relevant product and the relevant wholesale access point.
- 4.2. Appropriate products will be wholesale access products (or a basket of wholesale access products) in those areas where broadband is commercially provided with similar characteristics to the access product(s) (or basket of access products) that will be provided using the subsidised infrastructure.
- 4.3. However, as noted above, the relevant benchmark will also depend on the point of wholesale access to the subsidised infrastructure. In principle the wholesale access point should be positioned as far upstream as possible whilst facilitating effective and sustainable downstream competition. Thus, a wholesale access point positioned any further upstream would not achieve effective and sustainable downstream competition whilst a wholesale access point positioned further downstream would be forgoing some aspects of competition. In practice the optimum wholesale access point is likely to vary depending on factors such as geography/location, size of the implementing broadband project and the technology involved. This implies that the benchmarking exercise might suggest a number of price ranges that would vary according to the position of the wholesale access point in the broadband supply chain. As a result, the appropriate benchmark product to use will need to be considered on a case by case basis, taking the other principles set out above into account.

- 4.4. In order to illustrate the potential range of access points which may be used as appropriate product benchmarks, Figure 1 shows, as an example, a network diagram of the current wholesale local access (WLA) market and wholesale broadband access (WBA) market remedies, which apply to BT where it has significant market power. It also shows BT's network access points to which communication providers (CPs) need to interconnect in order to provide broadband and/or voice services to end users (the interconnection points mark effectively the boundaries beyond which traffic is handed over to the CP's network).

Figure 1 – WLA and WBA markets: network interconnection points and remedies



- 4.5. In addition to the wholesale access products that BT is currently required to provide in the WLA and WBA market remedies, BT is also currently required to provide wholesale access products in the Business Connectivity Market, for example Ethernet leased lines and dark fibre.
- 4.6. In practice, BT's regulated wholesale access products are likely to make good benchmark products, as their prices are published and they generally represent what is happening in the commercial market. However, other suitable benchmarks may also be available, e.g. the products/prices on alternative commercial sub-national or local networks.
- 4.7. It may be the case that no suitable benchmarks are available and in such cases the Commission's Broadband Guidelines suggest that the prices should follow the principle of cost orientation. However, in this situation it may also be possible to use some aspects of existing wholesale access products. For example, to the extent that there is an overlap between the products required by the State aid contract and existing wholesale access products it may be possible to benchmark this overlap and then adjust it accordingly.

Identifying appropriate benchmark products - incremental broadband versus standalone

- 4.8. It is important that the commercial pricing structure is recognised and properly captured in any benchmarking exercise. For instance, most commercially provided broadband services are provided on the basis that they are incremental to a telephone line rental service. Thus, consumers need to purchase line rental as well as the broadband service.
- 4.9. Where the broadband service is sold incrementally to the existing line rental service, the consumer would be required to purchase an existing line rental service before they can purchase the publicly funded superfast broadband service. Accordingly, the appropriate commercial benchmark would be the price for an incremental superfast broadband service (e.g. BT's FTTC GEA prices).
- 4.10. Where the broadband services is sold on a standalone basis, the consumer would be able to purchase the publicly funded superfast broadband service without needing also to purchase any existing commercial services. Here, the appropriate commercial benchmark would be either: the price for a standalone broadband service (e.g. BT's FTTP GEA prices); or the price for an incremental broadband service (e.g. BT's FTTC GEA prices) plus the price for line rental.

Non-NGA / non-broadband services

- 4.11. The Decision requires that wholesale access be made available for any electronic communications purpose. As a result, BDUK's approach to benchmarking reflects the full range of services that may be offered using the subsidised broadband infrastructure.
- 4.12. In relation to the benchmark product to be used, BDUK has considered the potential distortions that the provision of non-broadband products could have on commercially provided services and how to minimise these potential distortions.
- 4.13. As discussed above, one way of minimising the distortion is to require the prices for publicly funded services not to be lower than commercial benchmarks for comparable services.
- 4.14. The following conditions will apply regardless of the non-broadband product sold:
 - (a) Deployment will be limited to the white NGA areas targeted by the deployment of the subsidised broadband infrastructure. It will not be possible in build out into black NGA or grey NGA areas, even if such extension were funded by private sector investment;
 - (b) Prices of the non-broadband products must also be set in a manner consistent with this price benchmarking guidance note;

- (c) Wholesale access to the subsidised infrastructure must be permitted to other access seekers in line with the Guidance on Wholesale Open Access Network Requirements in order to enable them to offer the same non-broadband products on equivalent terms;
- (d) Additional non-broadband revenues beyond the forecast levels will contribute towards the identification of excess subsidy as part of the claw-back mechanism.

5. Benchmarking and the implementing body's role

Project design

- 5.1. Implementing bodies need to ensure compliance with State aid requirements when designing their projects. An integral part of this is ensuring compliance with the benchmarking requirement as detailed in this guidance note. The closer an implementing body can be aligned to the BDUK recommended approach set out in Section 3 of this guidance, the easier its path to approval under the aid scheme is likely to be.
- 5.2. In the first instance implementing bodies need to be clear on their benchmarking parameters in their tender documentation. In the case of those following the BDUK recommended approach, this would include those parameters set out in paragraph 3.2, including the implications of departure from agreed benchmarking principles. Implementing bodies must also be clear in their tender documentation as to the period during which the benchmarking requirement will apply. As a minimum, it must match the wholesale requirements of the 2016 NBS which is a minimum of seven years for existing infrastructure and indefinitely for new infrastructure.
- 5.3. Implementing bodies should also look to extract the relevant information from suppliers to be able to compare their different offerings. This would include: the wholesale access products they propose to offer (NGA, and non-NGA, and non-broadband, to the extent such products are permitted by the implementing body); their proposed benchmarks for each of these products and the justification as to why such benchmarks are suitable; the component parts of these benchmarks where appropriate; and the proposed benchmarking mechanism and pricing policy.

Accepting benchmarking points

- 5.4. During the procurement process, bidders should submit their wholesale product pricing along with the relevant benchmarks. The supplier should set out a comparison of the wholesale product prices against the benchmark data, justifying and providing evidence of any deviation to the implementing body, and setting out proposals for changes to the pricing to bring in line with the benchmarks.
- 5.5. The implementing body will need to assess the supplier's justification for any price variations using the guidance set out in this document and with the support of BDUK.
- 5.6. Supplier bids should include the benchmark data for their wholesale products. This needs to be agreed by the implementing body.

State aid application

- 5.7. Under the 2016 NBS BDUK will consider implementing bodies' applications to rely on the umbrella aid scheme. There is an application template for this purpose.⁵ Implementing bodies will be required to complete and return this to BDUK, together with relevant supplementary documentation indicated in the template.
- 5.8. The template requires implementing bodies to confirm they have complied with the benchmarking requirement (i.e. the requirement set out in the BDUK State aid notification and elaborated upon in this guidance note). More specifically, this means that implementing bodies will have to:
 - (a) Confirm whether they followed the BDUK recommended approach to benchmarking set out in Section 3 of this guidance note;
 - (b) If not, explain the extent to which they departed from it, reasoning for that approach, and how that alternative approach complies with the benchmarking principles set out in this guidance note;
 - (c) Provide relevant extracts from the tender documentation setting out the implementing body's benchmarking requirements;
 - (d) Provide a copy of the relevant contract extract showing the benchmarking mechanism agreed with the successful supplier, including detail of the benchmark products (for all NGA, non-NGA, and non-broadband products) and pricing policy.
- 5.9. In the event that the proposed approach is novel or different BDUK may seek technical advice from Ofcom in terms of the appropriateness of the wholesale benchmark pricing points and pricing policy proposed.

⁵ State aid application form is available on request from implementing Bodies email: stateaidforbroadband@culture.gov.uk

- 5.10. BDUK's review of compliance with the benchmarking requirement will be conducted as part of its overall second stage review. Provided implementing bodies can demonstrate compliance with this and other requirements (e.g. wholesale access, claw back, etc), BDUK will provide approval under the umbrella aid scheme to enable the public funding to be given under the contract with the successful supplier.

Reviewing wholesale product pricing

- 5.11. During the contract life, the supplier shall conduct an annual benchmarking review of the wholesale product prices against the benchmark data. The supplier should set out a comparison of the wholesale product prices against the benchmark data, justifying and providing evidence for any deviation to the implementing body, and setting out proposals for changes to the pricing to bring it back in line with the benchmarks.
- 5.12. Where a supplier is obliged to conduct this review on the same products against the same benchmark data for multiple implementing bodies, BDUK may coordinate the process to minimise effort for all parties.
- 5.13. The implementing body will need to assess the supplier's justification for any price variations using the guidance set out in this document and with the support of BDUK.
- 5.14. Where the benchmark review identifies prices that are higher or lower than the benchmarks and the supplier is unable to provide reasonable justification for the deviation, the implementing body should require that the supplier adjusts their pricing to better align with the benchmark data as soon as reasonably practical and/or report such deviation to BDUK.

Management of complaints

- 5.15. It is expected that any complaints in relation to access pricing will be directed in the first place to the successful supplier. For that reason, implementing bodies must ensure that their contracts require the supplier to notify them immediately if any such complaint is received. In most cases it is expected that the matter will be able to be resolved at that level. Implementing bodies should work with suppliers to determine whether the supplier is actually delivering what it promised to under the contract and that it is not departing from those terms. Should it not be possible to resolve the matter at that level, it must be escalated by the implementing body to BDUK. BDUK will intervene as appropriate to resolve the dispute. It will also seek technical advice from Ofcom if required to resolve the dispute, if required.

Reporting and compliance

- 5.16. BDUK requires implementing bodies to report certain information to it on a regular basis to allow BDUK to monitor the delivery of the local broadband projects and, crucially, their ongoing compliance with the umbrella aid scheme conditions. State aid compliance must be ensured throughout the life of an implementing body's contract with the successful supplier. Implementing

Bodies will need to report to BDUK on benchmarking on an annual basis, in particular:

- (A) Any variations to the benchmarking provision;
- (B) Any challenges (e.g. State aid or public procurement related) lodged with the implementing body or relayed to the implementing body in relation to the project. Such challenges could relate to access pricing.

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