

16th June 2014

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Dear Charles

Annual Licence Fees: Vodafone comments on Ofcom publication 'Update on European auctions since Ofcom's consultation on Annual licence fees for 900MHz and 1800MHz spectrum'

Please find attached a report by Frontier Economics and an update to the country case-studies previously submitted which, together with this letter, constitute Vodafone's submission in relation to the above-mentioned document.

In this context, I would like to highlight to you a number of procedural concerns that arise out of Ofcom's latest publication; these concerns have a bearing on the content of our submission (as well as that of other industry stakeholders). If they remain unaddressed, they have clear implications for the soundness of Ofcom's consultation and decision-making process in relation to the setting of Annual Licence Fees ("ALF").

Unclear how Ofcom intends to treat the evidence

In its most recent ALF-related publication of 16 May 2014, Ofcom notes that a number of spectrum auctions have been held in EU or EEA Member States since the publication of its consultation document of 10 October 2013 on the setting of ALF. However, whilst Ofcom discloses a list of the national markets in which these auctions have been held and invites comments from stakeholders about these auctions, Ofcom makes no attempt at any point to articulate to stakeholders how it intends to use or rely upon the data from these auctions when seeking to determine the appropriate level of ALF. Specifically, there is no indication as to the weight which Ofcom intends to place upon these auctions for the purpose of any international benchmarking exercise used to derive the value of 900MHz and 1800MHz spectrum.

Instead, Ofcom expressly states that it is still considering how to assess the relevance of the information from these auctions before embarking upon an analysis of the recent auction of spectrum in Austria. On that basis, the status of this document in the policy-making and consultation process in this case is far from clear; certainly, it cannot be classified as a consultation document that provides an insight into Ofcom's proposed or provisional approach to the use of the more recent auction data.

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The simple point of procedure is therefore that Vodafone (and other stakeholders) are providing responses to an Ofcom publication that lacks a clear frame of reference; these stakeholders are thus in the position of seeking to second-guess Ofcom's view as to the way in which this data should be used. This absence of any wider context from Ofcom means that we are also unclear as to the criteria that Ofcom intends to apply in deciding whether it will be used. Our submission therefore proceeds upon certain assumptions about the application of Ofcom's analytical framework to the data concerned.

This is not a mere technicality, but a matter of considerable significance given the potential consequences of revisions to the existing level spectrum licence fees for mobile operators and the consumers they serve. It is therefore critical that Ofcom's process should ensure that stakeholders are appropriately informed when formulating their responses to Ofcom publications given that these responses should logically assist Ofcom to set an ALF that attains its statutory duties. In this case, the publication of data extrapolated from the recent Austrian auction, coupled with footnotes containing references to other auctions (with much of that material not available in English to stakeholders) is not consistent with Ofcom's own guidance.¹

Lack of transparency regarding Austrian evidence

Our concerns about the status of this document and the lack of insight into Ofcom's position are magnified in a situation where there are significant questions about the transparency and robustness of the process by which data from the Austrian auction has been extracted. As explained in further detail in Frontier's report, the robustness of estimates generated from the Austrian auction must be questionable in circumstances where neither Ofcom nor its consultants, DotEcon, are in a position to verify whether the Austrian regulator has correctly applied DotEcon's methodology to the bid data generated in that auction.

As a real-life example of this risk, in relation to the UK auction Vodafone identified a discrepancy between DotEcon's and its own calculations of linear reference prices (LRPs) but was able to identify its cause thanks to its access to the underlying bid data. While this discrepancy did not turn out to be particularly material, the lack of such transparency in the case of Austria prevents Vodafone from conducting such a cross-check at all. Further details are set out in the Annex to this letter.

More specifically, for reasons that are explained further in Frontier's report, without access to the underlying bid data, it is not possible for Ofcom or industry stakeholders to form meaningful assessment about the robustness of the LRP estimates as an appropriate indication of the clearing price for the relevant spectrum in Austria versus other drivers such as strategic exclusionary bidding, private values generated by sunk costs or price setting bids.

There also appears to be an inconsistency in Ofcom's approach to gathering international evidence from combinatorial clock auctions (CCA). In the case of Austria it has gone to considerable lengths to attempt to derive the LRPs while no similar evidence is presented for other CCAs such as Slovenia, Slovakia, Norway, Netherlands and Switzerland. We understand from discussions from Ofcom that this discrepancy is due to different levels of cooperation it has received from the relevant other regulators but nowhere in either its original consultation nor in this Update does Ofcom confirm that it has approached all NRAs with

¹ "Consultation is an essential part of regulatory accountability the means by which those people and organisations affected by our decisions can judge what we do and why we do it..." Ofcom then further explains what its approach to consultation means in practical terms: " We will try to...help those with views to respond fully and in an informed way; and listen to those responses and use them to help understand the effect of any action we take...We will also try to...do this clearly and openly so everyone can see what is happening when, and why."(see <http://stakeholders.ofcom.org.uk/consultations/how-will-ofcom-consult>)

potentially relevant CCA evidence in a consistent manner.² The absence of this information leaves the impression of Ofcom making more strenuous efforts to gather evidence in the case of higher priced auctions than those with lower prices and thus cherry-picking benchmarks.

Next steps

Given the nature of the concerns described above, the most appropriate way of remedying the procedural defects identified above would be for Ofcom to issue a new consultation document once it has formed a provisional view about the extent to which it intends to rely upon the new evidence and is able to provide its reasoning for its analysis. Such an approach is consistent with its approach in the recent consultation document of 17 April 2014 about the methodology Ofcom proposes to adopt if it were to derive the appropriate discount rate for annualising lump sum values on the basis of CPI rather than RPI.³

A proper consultation articulating Ofcom's provisional assessment of the recent auction data, the weight to be attached to that data, how Ofcom intends to apply it to the UK and confirming a consistent approach to gathering international evidence is much more apt to elicit effective and useful responses for the purposes of Ofcom's decision making process. Vodafone therefore looks forward to engaging further with Ofcom about the subject matter of Ofcom's publication of 16 May once Ofcom is in a position to provide its provisional assessment of the aforementioned data in a formal consultation document.

Yours sincerely,



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Cc: Martin Ballantyne

² In fact, 4.9 of Ofcom's original consultation states that it only approached some NRAs (Netherlands and Ireland) who held a relevant CCA.

³ <http://stakeholders.ofcom.org.uk/consultations/900-1800-mhz-fees-cpi/summary>

Annex: Application of DotEcon's Linear Reference Pricing Algorithm

In the UK, DotEcon's calculations⁴ of linear reference prices were discrepant with Vodafone's own calculations as submitted to Ofcom⁵ as a result of the peculiar way DotEcon treated the unsold D1 and D2 categories. DotEcon removed these categories from the LRP optimisation by deeming that any bids made for packages containing D1 or D2 lots were instead made for corresponding smaller packages not containing these lots (see footnote 6 on page 9 of the DotEcon Report). This created a rather bizarre situation whereby Telefonica is deemed to have a **losing** bid of 1262.803m for the package containing the A2 lot (after having removed the D1 lot), whereas it already made a smaller **winning** bid of 1219.003m for the same package.

This results in an entirely spurious "excursion" on the winning package, which the LRP optimisation has to then try to minimise (see Table 23 on page 45 of the DotEcon Report). Vodafone believes that a more consistent methodology for dropping the unsold categories from the analysis (as stipulated at paragraph A12.36 of Ofcom's Second Consultation⁶) is to ignore any bids for packages containing those categories, and then run the LRP calculation over the remaining bids. Or, in an approach which is mathematically equivalent, but more illuminating, allow the LRP optimisation to assign non-zero prices to the unsold categories, just sufficiently high to rationalise the fact that they were unsold, and so ensure no excursions arise on packages containing these categories. This methodology leads to the results submitted in Vodafone's Observations. In the case of the UK auction the discrepancies between Vodafone's and DotEcon's approach were minor, and the other difficulties with the LRP approach were much more significant, so we did not pursue this point further.

However, this example demonstrates how anomalies in the calculation of LRPs can occur and, in the case of Austria, none of Vodafone, Ofcom, DotEcon or other stakeholders have any way of determining whether similar (or other) problems have arisen. One particular concern is the use of condensed categories (combining A1-A3, B1-B3 or C1-C3): depending on the approach deployed this may again create artificial "deemed" bids for packages which were not available in the real auction, or may create spurious excursions arising from "losing" bids for packages which when condensed turn out to be identical to winning packages.

⁴ 800MHz and 2.6GHz linear reference prices and additional spectrum methodology", Report prepared for Ofcom, September 2013 ("the DotEcon Report")

<http://stakeholders.ofcom.org.uk/binaries/consultations/900-1800-mhz-fees/annexes/linear-reference-prices.pdf>

⁵ Observations from the UK 800MHz and 2600MHz auction 2013 ("Vodafone Observations")

[http://stakeholders.ofcom.org.uk/binaries/consultations/900-1800-mhz-fees/responses/Vodafone Observations from the UK 800MHz and 2600MHz auction 2013.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/900-1800-mhz-fees/responses/Vodafone%20Observations%20from%20the%20UK%20800MHz%20and%202600MHz%20auction%202013.pdf)

⁶ Second consultation on assessment of future mobile competition and proposals for the award of 800 MHz and 2.6 GHz spectrum and related issues