

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: **SRSP : The revised Framework for Spectrum Pricing**

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Name **Chris Cheeseman**

Signed (if hard copy)

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**BT response to the Ofcom Consultation on:
SRSP: The revised Framework for Spectrum Pricing**

BT response to the Ofcom Consultation on: SRSP: The revised Framework for Spectrum Pricing¹

1. Introduction

BT is encouraged by the fact that Ofcom is now taking steps to undertake this Strategic Review of Spectrum Pricing. Broadly speaking BT is in agreement with Ofcom's pricing proposals. However, while we acknowledge the comprehensive nature of your review our concerns lie particularly with some of the timescales proposed for action.

BT is especially supportive of Ofcom's intention to take greater account of relevant market indications (e.g. auction results) when setting AIP. In this context we welcome the proposal to review the fixed links detailed fees algorithm as a priority and would encourage Ofcom to initiate that review at the earliest opportunity. In our view the fixed links annual fees that we are currently being charged are higher than we believe should be the case given the fixed link spectrum values indicated by the 2008 fixed links spectrum auction. We would suggest that whatever the outcome of this strategic review, any future system needs to be able to be more responsive to the market indications which are deemed relevant.

However, whilst we mostly support the approach that Ofcom is taking in relation to spectrum pricing, we do have some concerns and questions in relation to the General Principles and other proposals that Ofcom has outlined. Further detail on all these matters is given in our answers to the consultation questions set out below. We look forward to Ofcom's response to the points raised and we will await Ofcom's conclusions on the subject of the revised framework for spectrum pricing with interest.

2. Answers to the questions in the consultation document

General principles

Question 1: Do you agree with our proposed core principles of setting AIP? Are there additional matters that it would be helpful to clarify?

Proposed principle 1: role of AIP

AIP should continue to be used in combination with other spectrum management tools, in both the commercial and the public sectors, with the objective of securing optimal use of the radio spectrum in the long term. AIP's role in securing optimal use is in providing long-term signals of the value of spectrum which can be indicated by its opportunity cost.

BT agrees with the Proposed Principle 1. We also note that using AIP to reflect *full market value* has been discussed by Ofcom in relation to the proposed liberalisation and trading of retained 2G mobile spectrum and by the Government in 2009/10 in relation to its Digital Britain proposals. We understand that the effect pricing of spectrum at "full market value", rather than based on the

¹ A revised framework for spectrum pricing, http://www.ofcom.org.uk/consult/condocs/srsp/srsp_condoc.pdf

marginal value as at present, would both incentivise efficient use of spectrum and at the same time result in the “consumer surplus” being captured by the public purse.

Proposed principle 2: users can only respond in the long term

The purpose of AIP is to secure the optimal use of spectrum in the long term, so as to allow users to be able to respond to AIP as part of their normal investment cycle. Even where users have constraints imposed on their use of spectrum, in general, some if not all users have some ability to respond to AIP.

Proposed Principle 2 seems to be the expression of a constraint and BT feels it is not an unerring rule but more a caution. In some circumstances it is the cost and lifetime of the transceiver equipment being used which dominates a licensee’s ability to improve his spectrum efficiency. In such a case spectrum use can only be made more technically efficient by changing out this equipment. Where this is true, we agree that this principle will often work to delay a response to changes in AIP into the longer term. This might apply for example to those licences which are primarily “apparatus” based. This is often the case where it is the availability of apparatus which has driven the efficiency of spectrum use and is common in the licensing of fixed links. However, where licences are for specific spectrum which may be supporting more widespread network use, responding to AIP signals in a somewhat shorter time frame may be more likely. This is because there are other factors that could alter the amount of spectrum needed, such as by adjusting the configuration of the network (e.g. adding cells or base-stations) or the sharing or trading of some spectrum . These factors are not determined by equipment lifetime and are often much more market driven, they could therefore potentially allow a response to a spectrum pricing stimulus in the shorter term.

Proposed principle 3: when AIP should be applied

AIP should apply to spectrum that is expected to be in excess demand from existing and/or feasible alternative use, in future, if cost-based fees were applied. In determining *feasible* alternative uses, we will consider the relevant timeframe, any national or international regulatory constraints, the existence of equipment standards, and the availability and cost of equipment.

BT agrees with the Proposed Principle 3.

Proposed principle 4: the ‘relevant timeframe’ for AIP

In general, we seek to assess excess demand, congestion and feasible alternative use over a timeframe that reflects the length of existing users’ investment cycles.

BT partly agrees with the Proposed Principle 4, but as in our comments against Principle 2, the ability to share/trade spectrum and reconfigure networks may also affect the choices available to the licensee, so that there are a mix of factors important in determining the “relevant timeframe”.

Proposed principle 5: AIP and spectrum trading

Many secondary markets are unlikely to be sufficiently effective to promote the optimal use of the spectrum without the additional signal from AIP. Therefore AIP will likely continue to be needed to play a role complementary to spectrum trading for most licence sectors.

BT agrees with the Proposed Principle 5, at least while market mechanisms are not well established and if where competition considerations might provide a significant disincentive to trade.

Proposed principle 6: AIP and wider policy objectives

Socially beneficial uses of spectrum do not, as a general rule, justify AIP fee concessions, because direct subsidies and/or regulatory tools other than AIP are normally more likely to be efficient and effective. For cost-based fees there might be some circumstances in which it could be appropriate to provide a concession.

BT notes the reasoning behind the Proposed Principle 6 and has no specific comments.

Proposed principle 7: AIP and the promotion of innovation

It will generally not be appropriate to provide AIP concessions in order to promote innovation. We may consider whether cost-based fees should be set at a lower level in order to promote innovation.

BT agrees with the Proposed Principle 7.

Proposed principle 8: use of market valuations

We will take account of observed market valuations from auctions and trading alongside other evidence where available. However, such market valuations will be interpreted with care and not applied mechanically to set AIP fees.

BT agrees with the main thrust of Proposed Principle 8. This is one of the significant areas of change from the past approach and we agree that greater emphasis should be placed on this factor now that relevant data from auctions is becoming available.

Competition considerations may also be a relevant justification to align AIP and auction values for similar spectrum (e.g. if auction prices paid by parties that need to buy “new” spectrum to enter a market are higher compared to the AIP applied to historical spectrum assignments of incumbents in comparable markets then this would have a distorting effect that might jeopardize the promotion of competition).

Conversely, if AIP prices are much higher than would be indicated by relevant auction/trading information these should be reviewed to ensure that they are not higher than is necessary to help secure optimal and efficient use of the spectrum. In the case of fixed point to point links, we are of the opinion that the current level of AIP based fees is higher than is appropriate given indications from the 2008 fixed links spectrum auction. While we welcome the proposed review of fixed link fees and hope to achieve a simplification of the pricing formula and reduction of the level of fees we believe Ofcom should in the course of this review, identify a way of responding to such signals in a timely manner or indicating why it believes no response is called for.

Ofcom has clarified that it will take into consideration market data from spectrum trades and auctions when setting annual AIP charges for other similar spectrum. This will have the effect that market transactions will tend to not just reflect the value of the part of the spectrum that is to be traded/auctioned, but will also reflect how that market transaction will influence the future cost of the entire extent of spectrum that may be available either to that bidder (if similar, annually priced, spectrum is also held). A consequence of linking auction values with AIP on similar spectrum would be that the effective spectrum costs to all parties may tend to converge in the long term. In the short term, if AIP on similar spectrum is below market value, then newcomers, or those holding relatively small amounts of similar spectrum, might place greater value on new spectrum available at auction or by trading than parties already having large similar holdings and who could experience licence fee

increases on other spectrum holdings as a result of the market transaction. This could tend to encourage a more even distribution of spectrum where some similar new spectrum is awarded by auction and some existing spectrum is subject to AIP. If the combination of annual Administrative Incentive Pricing and market based auction pricing did result in more balanced spectrum holdings by the various market players this may assist in promoting long term competition at a platform level that could benefit customers.

Ofcom and the Government have more recently specifically referred to *full market value* in relation to the proposed future pricing of some types of mobile spectrum. However, historically spectrum pricing in the UK has tended to be calculated based on *marginal* spectrum values, rather than total spectrum values. We would be interested to understand how Ofcom proposes to decide which basis is appropriate in a particular case (i.e. marginal or full value), and how it plans to determine these values where relevant auction data is not available. We would emphasize that full market value cannot simply be computed from the marginal value.

Perhaps spectrum trades of part of a spectrum holding may be the better source of estimating marginal spectrum values, whereas relevant data from auctions of entire relatively large blocks of spectrum may be more useful for helping to determine full market value. Certainly it is BT's view that the most reliable method of determining market value of spectrum is an auction. However, whilst BT believes that a suitably designed auction will reveal the *market* value of spectrum it must be noted that this value will be affected by factors such as how much spectrum is made available to the market relative to the level of demand; the level of any caps on spectrum holdings; how high the barriers to entry into the market may be for a new entrant when considering the strength of existing players; as well as other more topical factors. In the case of some types of mobile spectrum, where barriers to market entry are very high, there is a risk that if market entry is not encouraged (e.g. with national roaming rights on existing networks) the release of additional spectrum would reduce or fail to capture the full value for the public purse; in such cases it could also be argued that the full market value is in fact not being revealed.

In our view auction information from outside UK markets can be illuminating, however its use needs to be tempered with consideration of UK specific market, regulatory, policy and legal attributes.

Proposed principle 9: setting AIP fees to take account of uncertainty

Where there is uncertainty in our valuations and the likelihood of demand for feasible uses appearing we will consider the risks from setting fees too high, or too low, in light of the specific circumstances. When spectrum is tradable we will consider the extent to which trading is expected to promote optimal use, and will also have particular regard to the risk of undermining the development of secondary markets.

BT agrees with the Proposed Principle 9. In our view the most important consideration is to avoid outcomes which lead to distortion of competition or creating barriers to innovation or investment.

Fee-setting methodology

Question 2: Do you agree that we should charge cost-based fees where AIP is not appropriate or AIP would not cover our costs? How do you think we should set cost-based fees in future fee reviews? Are there particular factors you think we should take into account, for specific licences fees or cost-based fees in general?

Yes, it seems reasonable that Ofcom covers its costs and that they are met by those that stand to benefit from the work that Ofcom undertakes. However a concern would be as to whether Ofcom has sufficient incentive to seek to reduce its costs in administering cost based fees if these can simply be passed on to licensees.

Question 3: Do you agree with our proposed fee-setting methodology principles (set out below)? Are there additional matters that it would be helpful to clarify?

Proposed methodology 1: AIP and congestion

In setting AIP fees, we will assess current and future congestion in existing use and demand for feasible alternative uses in the frequency band in question and at different geographic locations over the relevant timeframe, given technological, regulatory and international constraints and using readily available evidence.

BT agrees that this seems appropriate but believes that transparency may also be appropriate and thus the evidence which Ofcom uses should be clearly indicated. This will both allow additional evidence to be offered if appropriate and also provide a further mechanism for users to value and thus impetus to improve spectrum efficiency.

Proposed methodology 2: reference rates

Reference rates will be based on the estimated value of the spectrum in the current use and any feasible alternative uses. These estimates will be informed, where appropriate, by the available market information (if any), and economic studies of spectrum value.

BT agrees with the proposed methodology 2.

Proposed methodology 3: calculating individual licence fees

In converting reference rates to fees, we will take account of the value of the amount of spectrum denied to others. This will generally be based on frequency, geographical location, bandwidth, geographical coverage or other measure that reflects the geographical extent of co-ordination requirements, and in some cases the exclusivity of an assignment.

BT agrees with the proposed methodology 3.

Proposed methodology 4: impact assessments

We will undertake Impact Assessments on our fee proposals to identify any potential detrimental impacts to spectrum users, consumers and citizens. We will need to consider carefully the balance of benefits and risks of the implementation of all changes in fees.

BT agrees with the proposed methodology 4.

Plans and priorities for spectrum fee reviews

Question 4: Do you agree with our proposal to move away from regular full-scale reviews to reviewing in response to evidence, as set out in Option 5?

Yes, BT agrees that Option 5 is the best approach subject to comment made above in response to Question 1 on the proposed principle 8: use of market valuations. Specifically, the minimum term needs to be realistic and where known take into consideration planned events which may provide relevant evidence, for example auction of spectrum which may be in the same or a similar market.

Question 5: Do you agree with our process for assessing the priority of future fee reviews? Are there other sources of evidence of misalignment between fees and spectrum value or spectrum management costs that you can think of, and what weight should we give them?

Yes, BT agrees with the proposed process for assessing the priority of future fee reviews.

Question 6: Based on our proposed criteria, or other criteria you would propose we use, what do you think our priorities for future fee reviews should be? Please tell us your reasons for thinking these should be prioritised. Do you agree that we should prioritise a fixed link fee, as some stakeholders have suggested to us?

BT agrees that the fixed links fees algorithm should be reviewed as a matter of priority, and a revised fees structure developed as soon as possible. Indeed we are strongly of the view that a review should be initiated (and preferably completed) in FY 2010/11, rather than left as an item to be included and prioritized within in the Ofcom Annual Plan for 2011/12 as indicated on page 6 of the consultation paper. As indicated elsewhere, such a review is already overdue and as such may already be having a competition distorting effect.

Question 7: Do you agree with our proposed approach to post-review evaluations?

Yes, BT agrees with the proposed approach to post-review evaluations.