

Three  
Star House  
20 Grenfell Road  
Maidenhead  
SL6 1EH  
United Kingdom

T +44(0)1628 765000  
F +44(0)1628 765001  
www.three.co.uk



Alison Esslemont  
Floor 3, SPG  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA

21 June 2010  
Non-confidential

Dear Alison

**Three's response to Ofcom's consultation on SRSP: The revised Framework for Spectrum Pricing**

Three<sup>1</sup> welcomes Ofcom's consultation on the revised Framework for Spectrum Pricing<sup>2</sup> – in particular, Ofcom's proposed principles and methodologies for future spectrum charges. Three especially welcomes Ofcom's proposed principle that – in setting administered incentive pricing (AIP) fees for individual licences – Ofcom should reassess its pricing approach to ensure that AIP generally reflects the full market opportunity cost of spectrum use.

However, Three believes that Ofcom's proposal omits some fundamental economic and legal principles. Namely, that the purpose of AIP is not just to promote optimal use of spectrum, but also to help ensure that:

1. the administrative assignment of scarce spectrum promotes and does not hinder competition in the relevant markets;
2. the use of administratively assigned scarce spectrum results in a fair return to taxpayers for the use of a state resource; and

---

<sup>1</sup> Hutchison 3G UK Ltd.

<sup>2</sup> Ofcom SRSP: The revised Framework for Spectrum Pricing, Proposals following a review of our policy and practice of setting spectrum fees, 29 March 2010.

3. the holders of administratively assigned spectrum do not enjoy unfair State aid as a result of their spectrum holdings.

In addition, in accordance with Ofcom's proposed principles, Three considers that Ofcom should reassess setting of AIP fees for mobile telecoms spectrum as a matter of priority, as the level of AIP fees currently applying to existing 900MHz and 1800MHz mobile licences depart materially from full market opportunity cost.

### **Three agrees with Ofcom's proposed principles and methodologies**

Three agrees strongly with the main conclusions of Ofcom's proposal, that:

- radio spectrum is a valuable resource and that some frequencies are more valuable than others, especially when they are technically suitable for highly valued services or because their use is harmonised internationally;
- in circumstances where use of scarce spectrum for one purpose or by one user will limit its use by others, the mechanism by which spectrum is allocated and assigned between different uses and users inevitably plays a key role in encouraging its optimal use;
- the objective of securing optimal use of radio spectrum – namely, when it is used in a way that maximises the value to consumers and citizens – is more likely to be achieved if detailed decisions on how spectrum is used are left to those involved in its use rather than dictated centrally by a regulator;
- one of the purposes of AIP is to help secure optimal use of the radio spectrum where spectrum is scarce, by acting as a proxy for market prices and thereby promoting its optimal use by reflecting the opportunity cost imposed on society by its use (taking into account feasible alternative uses) and ensuring that users take this into account in their business and investment decisions, especially when it has been assigned administratively rather than by auction;
- there is no single spectrum market but rather a set of separate markets across the various frequency bands;
- spectrum markets remain immature, with limited liquidity and an absence of developed market institutions and price information that might make them more effective;
- trading and liberalisation alone is unlikely to be sufficient to promote efficient use in certain spectrum markets and so AIP is likely to have a more important role in such markets; and
- AIP is a valuable complement to spectrum auctions, trading and liberalisation and can usefully reinforce incentives from trading.

Three therefore supports Ofcom's proposed principles and methodologies.

Three also agrees with Ofcom's proposals to refine the pricing methodology applied in particular to the mobile telecoms sector, by tracking the value of spectrum between bands more precisely, so that not all bands would necessarily continue to be priced on the same reference rate.

### **Ofcom AIP principles should also address potential competition and State aid issues**

While Three strongly agrees with Ofcom's proposed economic principles and methodologies for setting the framework for spectrum pricing, Three considers that they are incomplete, by not explicitly addressing potential competition and State aid issues. In particular, Ofcom should establish the additional principles that, in setting AIP on administratively assigned spectrum, Ofcom should consider:

- the effect on competition in relevant markets, in particular, competition between holders of administratively assigned spectrum and other market participants or potential new entrants;
- whether taxpayers are getting a fair return on administratively assigned spectrum compared to the value to alternative uses or users; and
- whether administrative assignment of spectrum leads to the holders of such spectrum enjoying unlawful State aid.

This is because the purpose of AIP is not just to promote optimal use of spectrum, but also for Ofcom to meet its wider statutory objectives.

Three particularly notes Ofcom's duties under Section 3 of the Wireless Telegraphy Act 2006, that in setting AIP, Ofcom's should have regard to:

- the desirability of promoting efficient spectrum management and use;
- the economic benefits arising from the use of wireless telegraphy;
- the development of innovative services; and
- competition in the provision of electronic communications services.

Moreover, Ofcom's paramount duty under Section 3(1) of the Communications Act 2002 – which requires Ofcom to further the interests of consumers through the promotion of competition – overrides all of Ofcom's duties under Section 3 of the Wireless Telegraphy Act 2006.

While Three recognises that Ofcom's consultation does consider the impact of spectrum pricing on competition<sup>3</sup>, the consultation does not make this one of its key proposed principles. In particular, simply relying on the UK competition authorities to identify and address possible competition problems, we believe, significantly downplays the impact that spectrum pricing can have on competition.

Leaving competition regulators to address ex post competition problems as they arise is not a substitute for addressing ex ante competition problems that may be directly caused by choice of spectrum pricing policy.

### **Ofcom should reassess its setting of AIP fees for mobile telecoms spectrum as a matter of priority**

Three wholly supports the previous Government's draft direction in Parliament requiring Ofcom to revise the level of AIP fees applying to existing 900MHz and 1800MHz mobile licences to reflect the full market value of the frequencies in those bands. However, the existence of the draft direction does not mean that Ofcom should delay in reassessing its setting of AIP fees for mobile spectrum licences, as:

- the level of AIP fees currently applying to existing (“un-liberalised”) 900MHz and 1800MHz GSM spectrum mobile licences depart materially from full market opportunity cost, resulting in a combination of a distortion of competition, of taxpayers not getting a fair return on the use of that spectrum and of holders of that spectrum enjoying unfair State aid;
- “liberalisation” of the 900MHz and 1800MHz mobile licences will greatly increase the market opportunity cost of these licences;
- waiting until after the combined auction of the 800MHz and 2.6GHz mobile spectrum before specifying the framework for setting AIP fees on 900MHz and 1800MHz spectrum will add considerable uncertainty and potential distortion to the auction process, as well as prolonging the period when the AIP on 900MHz and 1800MHz is set well below full market opportunity cost; and
- any delay in the reassessment of AIP fees for mobile telecoms spectrum will prolong a situation of unlawful State aid to the current owners of such spectrum.

Furthermore, Three does not agree with Ofcom's assessment that AIP has been effective in incentivising decisions that were more likely to lead to optimal use of spectrum. Indeed, Three considers that AIP fees for mobile telecoms spectrum has had limited, if any, impact on decisions that might lead to optimal mobile spectrum use, as:

---

<sup>3</sup> Ofcom Consultation, 4.55-4.59.

- mobile telecoms spectrum is not currently tradable, therefore there is little opportunity to reassign it to alternative use or users;
- AIP on mobile spectrum is currently considerably below full market opportunity cost, therefore there would be no incentive to surrender it if its value in its current use were below the market opportunity cost of alternative use; and
- even if AIP were set at full market opportunity cost, there are large strategic incentives for current owners to hoard existing spectrum, thereby preventing it becoming available to alternative users who might be able to make more efficient use of it.

Moreover, Three considers that there is much evidence of inefficient use of current mobile spectrum holdings, including:

- under utilisation of 2G mobile spectrum compared to what can be achieved by international standards;
- excessively slow migration of customers from 2G to 3G technology;
- inefficient and unnecessary routing of 3G traffic onto 2G networks; and
- under-investment in 3G networks and under-utilisation of 3G spectrum;

Furthermore, the administrative assignment of 2G mobile spectrum and current AIP regime prevents such spectrum being available to more efficient alternative use or users.

Users of 2G spectrum will argue that slow migration from 2G to 3G technology does not represent inefficient spectrum use, as they plan to migrate traffic and customers directly from 2G to “4G” mobile technology. This view nevertheless presumes that 2G spectrum will be liberalised to its current owners for 4G use and disregards whether there might be more efficient uses or users of such spectrum.

Lastly, Three believes that the historic administrative assignment of 2G 900MHz and 1800MHz mobile spectrum in the UK and consistent under-pricing of AIP is an on-going situation of unlawful State aid to the UK 2G mobile operators. The effect of this has been to distort competition between 2G and 3G-only mobile operators and to materially disenfranchise taxpayers.

### **Three’s response to Ofcom’s specific questions**

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

Yes, Three agrees with Ofcom’s proposed core principles, but considers that certain core principles are missing, namely, the need to consider the impact on competition, on returns to taxpayers and on potential State aid in setting AIP.

*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, Three agrees on using cost-based fees where AIP is not appropriate. We do not have a specific view on how cost-based fees should be set.

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

Yes, Three agrees with Ofcom's proposed fee-setting methodology principles, except that certain key principles are missing. See response to Question 1.

*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, we are generally happy with this proposed approach, although there should be an automatic review in the event of certain predefined events, in particular, change of spectrum licence conditions.

*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?*

Three agrees with the proposed process for assessing the priority of future fee reviews. However, we do not believe that Ofcom is applying this process in the case of reviewing AIP for mobile spectrum.

*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 review, as some stakeholders have suggested to us?*

Ofcom's urgent priority should be to review AIP on current un-liberalised 2G 900MHz and 1800MHz mobile spectrum and on prospective liberalised 900MHz and 1800MHz mobile spectrum.

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

Yes, Three agrees with Ofcom's proposed approach. However, Three does not agree that Ofcom has adequately applied this in the case of mobile spectrum.

We look forward to participating further in Ofcom's consultation process.

Kind regards

Mark Falcon  
Head of Economic Regulation