

Annex 3.1 Legal analysis of Ofcom's second consultation on annual licence fees

1. Summary

- 1.1 This submission responds to Ofcom's consultation document 'Annual Licence Fees for 900 MHz and 1800 MHz – Further Consultation' (the 'Further Consultation') published on 1 August 2014.
- 1.2 Vodafone welcomes a number of shifts in Ofcom's thinking, notably that:
 - (a) deriving full market value is characterised by 'a high level of uncertainty'; and
 - (b) there is a risk arising from setting ALF too high.
- 1.3 Ofcom has failed to consider the implications of these changes to its thinking. Instead, it falls back on an error of law about the status of the Direction. Ofcom has not dealt at all with most of the points made in Vodafone's January 2014 submission. In the interests of brevity, some of the most critical points are reiterated here in summary form, but Vodafone directs Ofcom to that submission and respectfully asks that it also be treated as being made as a submission to the Further Consultation.
- 1.4 The critical point is that Vodafone's understanding of the legal duties engaged when Ofcom gives effect to section 6 of the Direction is fundamentally different to Ofcom's.
- 1.5 Vodafone understands Ofcom's position to be that:
 - (a) Ofcom's task is set by section 6 of the Direction. Ofcom's objective is to perform this task. No other statutory purpose or objective is relevant;¹ and
 - (b) Ofcom has no discretion whether to perform this task and, as a result, any exercise of discretion by Ofcom is of an extremely limited and technical nature.²
 - (c) Therefore, any decision on ALF is not governed by the same suite of duties as a decision taken in other circumstances. It is not necessary or appropriate for Ofcom to analyse and consider a range of different statutory concerns. As a result:
 - (1) Ofcom's duty to weigh up the extent to which any proposal would secure its statutory objectives, including by conducting an impact assessment, is only partially engaged. Ofcom accepts that it should undertake (and considers it has undertaken) a limited (or 'focussed') impact assessment to guide the discretion that it considers that it does have. The scope of that assessment is limited to a single issue, which is '*whether there is an asymmetric risk of inefficient use of spectrum from inadvertently setting ALFs below or above*

¹ Further Consultation at 1.42.

² Further Consultation at 1.43 – 1.44.

market value.³ Ofcom has decided that no impact assessment of the type described in Ofcom's guidelines will be undertaken; and

- (2) no other provisions of UK or EU law (for example, those dealing specifically with the setting of spectrum licence fees) are engaged. In essence, the Direction trumps all.

1.6 Ofcom's two premises at (a) and (b) are each wrong in law and, as a result, Ofcom's conclusion at (c) – that it should, in effect, sidestep any assessment of the merits of its proposals in terms of its wider duties (whether framed as an 'impact assessment' or otherwise) – is a fundamental error of approach.

1.7 Ofcom's premises are wrong because:

- (a) The duty imposed on Ofcom by section 6 of the Direction does not exist in a vacuum – it is part of the Direction, and the Direction is an element of the wider European Common Regulatory Framework for electronic communications ('CRF').⁴ As with all decisions taken by an NRA, spectrum licence fees must be set in a way that is consistent with the CRF, including only taking action to the extent it is necessary to do so to achieve a defined statutory purpose.⁵ Ofcom's analysis does not recognise the distinction between the *task* Ofcom is required to undertake and the *purpose* for which that task is being undertaken. As a result, Ofcom fails to identify any objective or purpose advanced by its proposals, beyond (by implication) giving effect to the Direction. But the Direction itself sets out its purposes and section 5 of the WTA06 provides that when giving effect to the Direction, Ofcom must act with a view to securing those purposes. Ofcom's other statutory purposes, particularly to secure efficient use of spectrum, also remain relevant and need to be taken into account. These purposes should inform Ofcom's approach to setting ALFs to reflect full market value. They are not dealt with adequately in either of Ofcom's consultations.
- (b) Ofcom's assessment that there is little or no discretion left to it by section 6 of the Direction is wrong on the face of Ofcom's own consultations, which reveal the very considerable discretion left to Ofcom at each stage of Ofcom's reasoning. The same finding also flows from the proper construction in law of the Direction (much of which is expressed in open language and requires interpretive judgements to be reached in giving effect to it, in relation to ALF as with other sections). Ofcom has confused a lack of discretion about *whether* to revise ALFs for a lack of discretion about *how* that task is to be done (and the outcome).

³ Further Consultation, paragraph A5.1.

⁴ The Common Regulatory Framework comprises the Framework Directive ('FD') (Directive 2002/21/EC), the Authorisation Directive (Directive 2002/20/EC), the Access Directive (Directive 2002/19/EC), the Universal Service Directive (Directive 2002/22/EC) and the Directive on privacy and electronic communications (Directive 2002/58/EC), as amended by the Better Regulation Directive (Directive 2009/140/EC).

⁵ Article 8, FD.

- 1.8 Therefore, any decision on ALFs needs to comply with the Direction and give effect to it, but in so doing, Ofcom remains governed by the other applicable duties imposed on NRAs under the CRF. This includes the duty to equip itself with sufficient evidence of the impact of its proposals to meet the requirements of section 7 CA03. Ofcom has decided not to do so.⁶
- 1.9 Therefore, any decision on ALF Ofcom now takes will be *ultra vires*.
- 1.10 Nor does the Direction suppress or exclude the rest of the CRF. For example, Ofcom remains bound by duties applicable under EU law in relation to spectrum licence fees – specifically, that any decision to set fees is proportionate. The Direction does not (and, as a matter of law, could not) abrogate protection under these provisions afforded to Vodafone under European law.
- 1.11 To the extent that these various provisions could be in conflict, Ofcom should act to resolve the conflict, not ignore it or give primacy to the Direction without proper analysis. To the extent it lawfully can, Ofcom should be giving effect to all its relevant duties, not a subset of them. If Ofcom’s view of the Direction is that it requires Ofcom to act in a way that is inconsistent with the other provisions of the CRF, then the Direction ought to be read so as to render it consistent with the CRF.⁷
- 1.12 Ofcom’s error of approach has led it into a procedural irregularity, namely the decision to decide not to conduct the impact assessment which Vodafone and other stakeholders had previously pointed out was required, with no adequate reasoning for that decision.
- 1.13 Until this error of approach is remedied, Ofcom is not in a position to conclude that its approach to setting spectrum fees attains its duties under the CRF, including achieving the purposes of the Direction. In the absence of this analysis, Ofcom is setting fees in a regulatory vacuum with no wider purpose in mind.
- 1.14 Nowhere is the problem of Ofcom failure to assess the impact of its proposals more clearly illustrated than in relation to how to phase in Ofcom’s revised ALFs. Ofcom appears to accept the submission, made by Vodafone and others, that the magnitude of the proposed changes means that some phasing-in is appropriate. But unlike other similar situations (such as setting the glide-path in a charge control) Ofcom does not equip itself with any analysis of the impact of its proposals. Are the interests of consumers best served by a shorter transition? A longer transition? Is there any relationship between the speed of the transition and any risk of inefficient use of spectrum? What would be the potential risks to competition? Ofcom has no idea. The limited analysis that it has undertaken (concluding ‘we should be conservative’) provides little useful steer. Ofcom opts to propose an arbitrary two year phasing,

⁶ Further Consultation, paragraph 1.43

⁷ Applying the principle set out in *Marleasing SA v. La Comercial Internacional de Alimentacion SA* [1990] ECR I-4135 at paragraph 8. For a discussion of this principle specifically in relation to the application of the spectrum regime, see for example *Ofcom v Floe* [2009] EWCA Civ 47 at 86-7.

without any objective justification or understanding of the implications. However without an objective, or any sense of impact, this proposal is simply a stab in the dark.

1.15 A better approach - and the obvious and lawful one – would be to revise ALFs in a way that is consistent with the approach that Ofcom brings to many tasks, which is to analyse its relevant duties, and to frame its proposals in terms of securing its statutory objectives and outcomes. To do so would be to act consistently with the approach that Ofcom has taken to implementing other parts of the Direction (it conducted an impact assessment to assist it in exercising its discretion to design the combined auction, for example) and in other parts of the CRF. Ofcom offers no reason for failing to adopt this well-established approach in this case.

1.16 This submission is divided into six sections:

- (a) This section 1, the executive summary;
- (b) Section 2, which discusses the core concern about Ofcom's duties, an issue that remains unaddressed following Ofcom's consultation and Vodafone's January 2014 submission;
- (c) Section 3, which identifies the changes to Ofcom's analytical framework that are welcomed by Vodafone;
- (d) Section 4, which discusses the consequences of Ofcom's decision not to undertake an impact assessment;
- (e) Section 5, which discusses how Ofcom ought to view the role of regulation in a forward-looking assessment of ALFs (for example, whether it should assume anything about the presence of spectrum caps); and
- (f) Section 6, which discusses the issues in relation to the phasing-in of any changes to ALFs.

2. The basic error in Ofcom's approach

- 2.1 This section 2 deals with deficiencies in Ofcom's procedure and analytical framework that remain following our response of January 2014 including Ofcom's error in law in the status and operation of the Direction, specifically, the failure to place the Direction in the context of the wider CRF.
- 2.2 As a result of its basic error in approach, Ofcom is not in a position to form any safe conclusions about whether its proposals for revising ALFs would meet its duties or be consistent with its obligations under the CRF (which it is obliged to do).

Construction of the Direction

- 2.3 Vodafone has previously identified in detail the relevant legal duties applicable to Ofcom and directs Ofcom to Annex 2 of its submission to the earlier consultation. This submission sets out in summary form the chain of logic illustrating the error of Ofcom's approach, but Vodafone reiterates the points made in Annex 1 of its previous submission which, in substance, have been ignored by Ofcom.
- 2.4 Ofcom's first step in a legal analysis of its duties when giving effect to the Direction ought to be the statutory context that governs the exercise of Ofcom's relevant powers to set spectrum licence fees under section 12 of the WTA06.
- 2.5 The second step in the analysis should be to ask: how does the Direction affect the exercise of these powers?
- 2.6 The proper outcome of that analysis is that the Direction fetters Ofcom's discretion whether to undertake a revision of ALFs, but it is not necessary to read the Direction as excluding the other duties imposed on Ofcom when it exercises its powers to set spectrum licence fees. In other words, the Direction determines *what* Ofcom must do – specifically, which powers Ofcom must exercise – but reveals no basis for departing from Ofcom's established practices and policy in relation to *how* those powers are used to set spectrum licence fees.

Step 1: Ofcom's general duties in relation to setting spectrum licence fees

- 2.7 Setting spectrum licence fees is one of Ofcom's radio spectrum functions.⁸ It follows that, in the event that when Ofcom is setting or revising spectrum licence fees in the normal course of its work:
- (a) Ofcom's general duties that apply to all of Ofcom's functions are engaged.⁹ These include:
- (1) Ofcom's primary duty to act to further the interests of citizens and consumers, including where appropriate by promoting competition;

⁸ Section 115(1) of the WTA06 provides that "radio spectrum functions", in relation to OFCOM, means their functions under the enactments relating to the management of the radio spectrum'.

⁹ Section 3 CAO3.

- (2) Ofcom's duty to secure in the exercising of its functions the optimal use for wireless telegraphy of the electro-magnetic spectrum¹⁰; and
 - (3) Ofcom's duty to act, in all cases, in a manner that is transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and in line with the best regulatory practice.¹¹
- (b) Ofcom's duties imposed on their radio spectrum functions generally are engaged.¹²
 - (c) Ofcom is bound to act in accordance with the six Community requirements (which give effect to Article 8 FD).¹³ The first requirement is to promote competition.
 - (d) Ofcom is required to undertake an impact assessment, unless the urgency of the case demanded otherwise, in a situation where Ofcom proposes to do anything for the purposes of, or in connection with, the carrying out of their functions.¹⁴

2.8 Ofcom's power to set licence conditions requiring the payment of spectrum licence fees is provided for in the WTA06. Ofcom may, if they think fit in light (in particular) of the matters to which they must have regard under section 3, prescribe sums greater than those necessary to recover costs incurred by them in connection with their radio spectrum functions.¹⁵ It follows that Ofcom may not impose spectrum licence fees above recovery of Ofcom's costs except in circumstances where Ofcom has had regard to those matters.

2.9 Ofcom's power to set spectrum licence fees and the applicable provisions under UK law governing the setting of spectrum licence fees gives effect to the relevant provisions of the CRF and so in interpreting these duties, Ofcom would be required to interpret those provisions consistent with the Directives. This includes ensuring that:

- (a) The UK regime operates so as to ensure that spectrum licence fees are '*objectively justified, transparent, non-discriminatory and proportionate in relation to their intended purpose and shall take into account the objectives in Article 8 [FD]*'.¹⁶
- (b) Spectrum licence fees must '*not hinder the development of innovative services and competition in the market*'.¹⁷

2.10 It follows from this analysis that in setting or revising spectrum licence fees:

- (a) Ofcom must act with an intended purpose in mind (an objective, beyond simply undertaking the task of setting spectrum licence fees);

¹⁰ Section 3(2)(a) CA03.

¹¹ Section 3(3) CA03.

¹² Section 3 and section 13 WTA06.

¹³ Section 4(1)(b) applies the six Community requirements to Ofcom's radio spectrum functions and section 4

¹⁴ Section 7 CA03.

¹⁵ Section 13(2) WTA06.

¹⁶ Article 13 FD.

¹⁷ Recital 32 FD

- (b) The decision to set or revise the fee would need to be judged to be proportionate to that purpose;
- (c) The matters that Ofcom must have regard to in making proposals would be those contained in section 3 of the WTA06 and, more broadly, section 3 of the CA03;
- (d) The evidence that Ofcom would be obliged to equip itself with would relate to the impacts on, amongst other things, consumers, competition, investment and innovation; and
- (e) In weighing up impacts, Ofcom must use that analysis to ensure that it avoids a number of specific harmful effects, in relation to any action that could hinder the development of innovative services, competition, and so on.

2.11 This approach is, we think, uncontroversial in circumstances where Ofcom is setting spectrum licence fees in other contexts. Consider this discussion from Ofcom's discussion in SRSP 2010, a document which sets out 'policy and practice' in relation to spectrum licence fees:

3.8 The Authorisation Directive states in Article 13 that Member States may impose fees for the rights of use of radio frequencies which reflect the need to ensure the optimal use of that resource. The WT Act, therefore, permits us to recover sums greater than those necessary to recover the costs incurred in connection with our radio spectrum functions. If we do so, we are required to have regard, in particular, to:

- *the extent to which the spectrum is available;*
- *present and likely future demand;*
- *the desirability of promoting:*
 - *efficient management and use of the spectrum;*
 - *economic and other benefits;*
 - *innovation; and*
 - *competition.*

3.9 We are also required to have regard to our general duties and the Community requirements set out in sections 3 and 4 of the Act respectively. Our primary duties are to further the interests of citizens in relation to communications matters, as well as the interests of consumers in relevant markets, where appropriate by promoting competition. Section 3(2)(a) of the Act requires Ofcom to secure the optimal use for wireless telegraphy of the electro-magnetic spectrum.

2.12 Ofcom also recognises in such cases the importance of including an assessment of the impact on particular stakeholders or interests of their proposals – again, specifically in the context of setting spectrum licence fees:

3.19 Given our belief that efficient use will promote maximum benefits for society from the use of spectrum, we aim to identify fee levels that will promote efficient use. However, we also need to consider the interests of particular groups in society, as set out in our general duties (and as required

under our duty to conduct an Impact Assessment including an Equality Assessment). Put simply, if efficient use can only be secured at a significant cost to a particular group of citizens or consumers, then while securing that increase might be efficient, it may not be optimal.

3.20 We would therefore consider the potential impacts on particular groups of citizens and consumers (as required by our general duties) before making fee proposals for consultation.

2.13 This statement makes it clear that it is Ofcom's express policy to undertake the sort of balancing of statutory interests urged by Vodafone and others in relation to the exercise of its powers under section 12 WTA06 generally.

2.14 In the SRSP 2010 statement, Ofcom also noted the events that would ultimately lead to the Direction being issued, and laid the ground for taking a different approach in light of the Direction, once it was issued:

3.52 Stakeholders should also note that the Government has recently laid a draft direction in Parliament which, if made, would require us to revise the level of annual licence fees applying to existing 900MHz and 1800MHz mobile licences to reflect the full market value of the frequencies in those bands. If the direction is made we would expect to consult, in due course, on our proposed approach to the implementation of this element of the direction. We would expect the details of our methodology to set annual licence fees to be specific to the requirements of the Government's direction, which could differ from some of the approaches set out in this statement for AIP.

2.15 As this extract makes clear, the SRSP 2010 approach represents Ofcom's policy with respect to setting spectrum licence fees generally, at the time that the Direction was issued and today. Ofcom's application of that policy in relation to setting ALFs for 900 and 1800 MHz spectrum pursuant to the Direction is (and has been since the SRSP 2010 statement) subject to the significant proviso that policy may be required to be adapted in light of the Direction. It is reasonable that Ofcom therefore flagged that once the final form of the Direction was known its approach could differ from that set out in the 2010 Statement. Implicit in Ofcom's position (and flowing logically from Ofcom's duties) is the premise that any such deviation from Ofcom's existing policy with respect to the setting of spectrum licence fees would occur only to the extent necessary to give effect to the Direction. Furthermore there is the implication that to the extent that it remained free to do so, the policy positions and approaches set out in the SRSP would be adopted in all other respects (or at least, any material deviation explained).

2.16 Across the two ALF consultations, Ofcom does make reference, in a single paragraph, to the various duties that govern the exercise of its powers. Ofcom recites the various duties (including those noted above) and then notes that:

3.35 In this document we set out our proposals for implementing the requirement in the Direction that we revise the fees for licences in the 900 MHz and 1800 MHz bands so that they reflect full market value, having particular regard to the sums bid for licences in the 4G Auction. In making these proposals we have considered our principal duty to further the

interests of citizens, and the interests of consumers where appropriate by promoting competition, and we have considered our duties relating to the optimal use for wireless telegraphy of the electro-magnetic spectrum, the desirability of encouraging investment and innovation, the desirability of encouraging competition, having regard to the interests of consumers in respect of choice, price, quality of service and value for money. We consider that our proposals for implementing the requirement in the Direction are consistent with our statutory duties.

- 2.17 These three sentences repeat the cursory assurance that Ofcom was ‘satisfied’ that its approach to ALF was consistent with its duties in the January 2012 consultation¹⁸ and the 4G auction statement in response to Vodafone’s concerns, raised consistently over a sequence of consultations, that Ofcom appeared set to adopt an approach to ALF that did not provide sufficient consideration of Ofcom’s relevant statutory duties. In the 4G auction statement, Ofcom noted that:

A12.55 We remain of the view that our proposals (which we note will be subject to further consultation by us before we make any final decisions on revised licence fees) are consistent with our obligations both under the Direction as set out above, and the European framework which permits us to set fees which reflect the need to ensure optimal use of spectrum, provided that we do so in an objectively justified, transparent, non-discriminatory and proportionate manner. We agree with Vodafone that the Direction must be interpreted consistent with the European framework. We do not however consider that the requirements of the Direction, nor our intention to set ALF after the Auction, are inconsistent with those European law requirements.

- 2.18 It is not clear however how Ofcom reaches this conclusion. No analysis has been provided to support these statements and it is not clear that Ofcom has, in fact, conducted any assessment of, for example, whether the interests of consumers are furthered as a result of the judgements Ofcom reaches about how to revise ALFs. Nor has it undertaken any consideration of any of the specific concerns listed, other than spectrum efficiency (which is very important, but does not exclude the need to consider the others). In particular, Ofcom does not undertake any sufficient assessment of competition (and to the extent that competition issues arise, Ofcom does not take any steps to update the assessment that was published over two years ago, building on analytical foundations laid in the consultations published in 2010 and 2011.¹⁹

Step 2: What is the effect of the Direction?

- 2.19 So how and to what extent does the Direction require Ofcom to *change* its existing approach to setting spectrum licence fees? Ofcom does not ask itself this question in its consultations, but it is a critical step in understanding how Ofcom ought to proceed.

- 2.20 The following sections of the Direction are most relevant to that question:

¹⁸ January 2012 consultation, Annex 13, paragraph A13.89 notes that ‘We consider that our proposals for calculating ALFs, which amongst other things take account of article 6 of the Direction, are compatible with our statutory duties under the domestic and EU legislative framework. *As we have said, we will consult on our exact proposal for calculating ALFs after the auction.*’ (emphasis added).

¹⁹ See Ofcom’s First Competition Assessment, Second Competition Assessment and 4G statement.

- (a) Section 2 of the Direction sets out the purposes of the Direction; and
- (b) Section 6 imposes the operative obligation on Ofcom to revise ALFs so that they reflect full market value.

2.21 Both these sections are relevant to Ofcom's exercise of its power to revise spectrum licence fees pursuant to the Direction. Ofcom errs in its treatment of each of them, by ignoring section 2 entirely and by over-reading section 6 as excluding for the most part any exercise of any discretion as to how it exercises its powers.

2.22 The legislative purpose of the Direction is important because:

- (a) where a direction under section 5 WTA06 '*specifies*' one or more purposes, that direction may require Ofcom to act '*with a view to achieving*' those purposes, when giving effect to the Direction; and
- (b) more broadly, the legislative purpose is widely recognised as an important touchstone in interpreting statutory instruments such as the Direction, especially where there is significant ambiguity or discretion in construing the relevant instrument.²⁰

2.23 The purposes identified in section 2 of the Direction are '*purposes ... specified in, or determined by the Secretary of State in accordance with, the order*' (i.e. the Direction). Section 5(3) provides that a direction *may* require Ofcom to act '*with a view to achieving such purposes*' as may be so specified.

2.24 Logically, there is an additional step, which is whether in practice the Direction really *does* have the effect that section 5 provides that it *may* have. We think there is no real argument that the Direction ought to be read as having that effect. The relevant interpretive points to consider in reaching that conclusion are:

- (a) The Secretary of State has identified the purposes that the Direction aims to achieve, as well as the tasks that Ofcom is to undertake to achieve those purposes. Section 2 ought to be read so as to have an operative effect. To interpret the Direction as not requiring Ofcom to act with a view to achieving those stated purposes therefore defeats the evinced legislative purpose of the Secretary of State in including the statement of purpose in section 2.
- (b) In any event, Ofcom is still required to act for a stated purpose (as a result of the demands placed on it by the CRF, including that it only act where it is proportionate to achieve a statutory purpose). Therefore, even if the purposes set out in section 2 of the Direction are not applied by virtue of section 5(3)(d), as interpretive tools to understand the Direction, they ought to be considered by Ofcom in any event alongside Ofcom's other relevant statutory purposes.

2.25 The simplest and most straightforward conclusion, consistent with giving effect to the legislative intent evident in the drafting of section 2 of the Direction, is that, to the

²⁰ See, for example, Fordham, 'Judicial Review Handbook' (5th ed) at Principle 53, at 53.1, which cites a sequence of cases summarised in support of the legal principle that 'Statutes are to be interpreted by reference to their purpose, and statutory powers must be exercised for the purpose for which they are conferred'.

extent that it exercises discretion or regulatory judgment, the Direction requires Ofcom to act with a view to achieving the purposes specified in section 2 of the Direction when it undertakes the actions it is required to undertake by the Direction.

2.26 Those purposes are:

- (a) ensuring the release of additional electromagnetic spectrum for use by providers of next generation wireless mobile broadband;
- (b) allowing early deployment and maximising the coverage of those services; creating
- (c) greater investment certainty for operators; and
- (d) implementing the Liberalisation Directive and Decision on the liberalisation of frequencies in the 900MHz and 1800MHz bands.²¹

2.27 These purposes are clearly relevant to the policy context for the revising of ALF for 900 and 1800 MHz spectrum.

2.28 This point was raised by Vodafone in its January 2014 submission. Ofcom does not consider this issue at all in its proposals.

2.29 Setting that issue to one side, the other relevant question is: what does section 6 require?

2.30 Section 6 provides that:

Licence fees

6.—(1) After completion of the Auction OFCOM must revise the sums prescribed by regulations under section 12 of the WTA for 900MHz and 1800MHz licences so that they reflect the full market value of the frequencies in those bands.

(2) In revising the sums prescribed OFCOM must have particular regard to the sums bid for licences in the Auction.

2.31 Section 6 does not determine the level at which ALFs must be set, nor does it precisely determine the basis on or the method by which they must be set. Prior to the auction, Ofcom was at pains to emphasise the discretion that it had over the way in which ALFs might be calculated pursuant to the Direction:

12.13 We have also considered whether it would be appropriate to specify a precise methodology for how we will set ALF after the Auction. However, to the extent that this drew on bids in the Auction (as required by the Direction), this would risk re-introducing a mechanistic approach, which, as

²¹ Direction, section 2. The Liberalisation Directive and Decision are Directive 2009/114/EC of the European Parliament and of the Council amending Council Directive 87/372/EEC on the frequency bands to be reserved for the coordinated introduction of public pan-European cellular digital land-based mobile communications in the Community and the Commission Decision 2009/766/EC on the harmonisation of the 900MHz and 1800MHz frequency bands for terrestrial systems capable of providing pan-European electronic communications services in the Community.

explained above, could distort bids in the Auction. We also consider that committing to a particular approach now would risk fettering our discretion to take account of all relevant factors or available evidence after the Auction.

12.14 We therefore consider that an appropriate way to balance these risks is to review the possible methodologies for setting ALF after the Auction, drawing on a range of different information whilst recognising the potential limitations of each source of such information. This will allow us to take account of all the factors that appear to us to be relevant at the time. In so doing, we consider that we are appropriately reducing the risk of inefficiency in the Auction by ensuring that there is no mechanistic link between Auction bids and ALF.²²

- 2.32 But section 6 clearly does impose a duty on Ofcom to undertake a revision of ALFs ‘so that they reflect the full market value of the frequencies in those bands’. As Ofcom points out, it has no discretion whether or not to undertake that task.
- 2.33 However, as with other provisions in the Direction, section 6 leaves a great deal to be resolved by Ofcom in the process of implementation. Sections 8 and 9, for example, provide a clear requirement that Ofcom was to conduct the combined auction, but left significant decisions and judgements to be taken by Ofcom (as set out in Ofcom’s decision). If there were any doubt as to the significant element of judgement involved in weighing up the different options open to Ofcom in revising ALFs, the evidence of Ofcom’s first and further consultation makes the point.
- 2.34 Issues relevant to the questions that the Direction does not determine, and that are thus left for Ofcom to resolve include:
- (a) the ultimate level of revised ALFs
 - (b) the precise method used to assessment ‘full market value’
 - (c) the nature of the relationship between full market value and the ALF (i.e. what it means that one ‘reflects’ the other); and
 - (d) how to implement revised ALFs.
- 2.35 As a result of these open issues and questions, the range of possible revised ALFs that Ofcom might consider is very wide. The significant variation between Ofcom’s first and second set of proposals emphasises this wide ambit of discretion.
- 2.36 Weighed against the evidence set out in Annex 1 to this submission, Ofcom’s assertion that it has ‘no discretion’ in relation to the revision of ALFs is revealed as true only in a technical and misleading sense. While there is no precise scale as to degrees of discretion, it is clear that in giving effect to the Direction, there are important issues left to Ofcom to resolve – not just matters that are ancillary or mere detail, but substantial questions, the answers to which have a material impact on the possible outcome of Ofcom’s calculation of the revised ALFs.

²² 4G statement, paragraphs 12.13 – 12.14. Emphasis added.

2.37 Vodafone's submission is a simple one. In reaching those judgments, Ofcom ought to be acting consistent with its general set of duties that are applicable to the exercise of its powers under section 12 WTA06. One of those requirements is that - as it is in relation to all its actions – Ofcom does no more than is necessary to achieve its objective.

2.38 But what is that objective? Ofcom seems almost deliberately to avoid the issue and at no point sets out explicitly a view of their purpose or objective. But as a matter of substantive construction, it would appear that Ofcom's 'purpose' is 'to set ALFs to reflect full market value'. This is the sense in which Ofcom refers to ALF-setting as a purpose in itself (as seen in the numerous references to changing approaches on particular points of detail 'for the purposes of ALF', for example).

2.39 But referring to revising ALFs as a purpose in itself is a legal misnomer; it is not a 'purpose' in law that Ofcom could adopt to enable itself to assess the proportionality of its actions.

2.40 One obvious purpose (required to be adopted by statute and revealed as relevant on the face of the policy record) is to ensure efficient use of spectrum. Ofcom's 'focussed' impact assessment approach tacitly adopts this purpose (since it deals with risks to spectrum efficiency, not a range of impacts across different stakeholder groups).²³ Ofcom is duty-bound to secure spectrum efficiency as a matter of European and UK law. And yet in exercising regulatory judgement between, for example, different views of international benchmark data, Ofcom does not consider at all whether the approaches they adopt will achieve this purpose or not. Instead, Ofcom remains focused on revising ALFs as an end in itself.

2.41 In the first consultation, Ofcom did not address this contradiction, which was characterised in one submission as Ofcom seeking to 'have its cake and eat it, too':

"Ofcom argue that ALF is necessary to promote spectrum efficiency but their own assessment of the impact of the proposed ALF indicate there is little or no impact on services to consumers, competition, investment, innovation and spectrum trading. These arguments do not seem internally consistent.

*We analyse Ofcom's arguments alongside other evidence and reach the opposite conclusion, namely that ALF would not promote (and may actually harm) spectrum efficiency and would likely reduce investment and/or raise prices. Therefore the proposed ALF would involve harm rather than benefits.'*²⁴

2.42 Could 'revising ALFs to reflect full market value' alone constitute Ofcom's purpose, in law? Vodafone does not think it could for two reasons:

(a) First, because the Direction has a set of purposes, and sets out what they are.

²³ Annex 5.

²⁴ Plum Consulting, Report for EE (forming Annex 2 of EE's submission to the First Consultation) at page 1.

- (b) Second, because even if the Direction were silent on the question of its purpose, Ofcom's purpose should be derived from its wider statutory duties, which remain applicable.
- (c) Third, because even if 'revising ALFs to reflect full market value' were an end in itself, Ofcom does not assess whether or not its actions are necessary to achieve that objective. For example, Ofcom does not identify any mechanism to assess the proportionality of its proposals. Accordingly, even accepting that Ofcom's approach of condensing the consideration of a proper impact assessment into the single notion of being 'conservative', proportionality is still required. This raises the question: has Ofcom been conservative enough? Without an impact assessment, Ofcom cannot judge.

2.43 Ofcom has in any event already expressed a view on these questions and the likely impact of ALF – advising Government in 2010 that, far from being an urgent or pressing priority, adjustment to the ALF of 900 MHz spectrum was a residual action that would only be necessary in the event that a competitive distortion arose as a result of liberalisation of that spectrum:

*1.15 As regards any concern that the likely lower costs of providing 3G UMTS services using 900MHz spectrum, as compared with higher frequencies, might indirectly give rise to a competitive distortion (for example by virtue of a windfall gain to those operators with 900MHz licences), we firstly note that charging annual licence fees for 900MHz spectrum that reflect the full market value of that spectrum ought to mitigate if not entirely eliminate any such distortion. **Furthermore, even if annual licence fees were not accurately to reflect full market value (and in particular the differential in value between 900MHz and higher frequency spectrum) we consider the impact on consumers to likely be limited.** This is because we consider it unlikely that any difference in cost would have a material effect on competition, for the reasons set out in our February 2009 Consultation, and almost certainly would not lead to any existing player having to exit the market before alternative spectrum becomes available.*

2.44 This echoes a point Ofcom made in the First Consultation in the context of implementation (making the point the other way round – this time saying that even if ALFs were set to full market value, the effect on consumers would be limited).²⁵ The fact that Ofcom has made both these points without any material assessment of those impacts simply illustrates the problem: it is critical to assess that impact (which may be small) to inform the extent to which it is necessary, for example, or proportionate, to invest time and effort in pushing ALF proposals when the benefits to consumers may be limited. (And in event, in the case of the advice to Government, given that this view was expressed in 2010, it would not be appropriate to rely on this statement alone in the context of a decision on ALF, but it makes it clear that there is no particular difficulty associated with assessing the impact of these proposals).

²⁵ From the First Consultation, paragraph 6.19: 'In view of this, we consider it unlikely that the absence of a phase-in period will create shocks which are so out of line with the broad expectations of the licensees such that these might have harmful impacts on delivery of services to customers'.

2.45 Most importantly, it also makes it clear that revising ALFs is not undertaken in a vacuum and, in policy terms, it has an ‘intended purpose’ – that is, to balance the impact of incentives provided by ALFs and/or amounts paid at auction (all of which are an incentive to spectrum efficiency) on licensees in different spectrum bands. Given that this is (self-evidently) an exercise of Ofcom’s functions for a purpose related to competition, this underscores the need to act with the benefit of a proper impact assessment.

2.46 The conclusion that flows from this analysis is that:

- (a) Far from removing all discretion and suspending the operation of ‘policy business as usual’, the Direction does not require a major departure from Ofcom’s statutory framework; and
- (b) In fact, the opposite point becomes apparent: rather than Ofcom’s general duties and considerations of the impact of its proposals being unimportant or irrelevant (as Ofcom seems to believe), the proper construction of section 6 of the Direction leads Ofcom directly to the types of exercises of discretion and judgement where a consideration of Ofcom’s wider duties are most important to guide it as it considers complex questions of methodology and regulatory technique.

3. **Changes in Ofcom's analytical framework that we welcome**

- 3.1 There are a number of points in Ofcom's analysis that Vodafone considers to be a significant step forward, and that ought to be preserved in any further policy consideration of ALFs:
- (a) Deriving market value for the purposes of the Direction is characterised by a high level of uncertainty;
 - (b) Ofcom's recognition of the uncertainty in deriving market value recognises that there could be a range of values that 'reflect' full market value;
 - (c) Ofcom's recognition that there is a risk of inefficient use of spectrum resulting from ALF being set too high (and that this risk is asymmetric) and the need to be correspondingly conservative in when setting the level of ALF; and
 - (d) Implicit Ofcom acceptance that the Direction allows (in fact, requires) it to take a conservative approach to the evidence when setting a full market value is a recognition that the Direction must be read in a way that gives effect to the objectives and principles of the CRF governing the management of radio spectrum.

4. **Ofcom's decision not to undertake an impact assessment.**

- 4.1 As described in section 2 of this annex, revising ALFs to reflect full market value is not a mechanistic exercise, but one that ought properly to be understood as seeking to secure one or more statutory purposes, namely to ensure that spectrum is in the hands of the holder who will value it most (as provided for in the Direction).
- 4.2 Given that Ofcom recognises that there is considerable uncertainty in deriving values for ALF and that there is a risk of ALF being too high, it follows that:
- (a) There is a range of potential values for ALF prospectively;
 - (b) Values at the higher end of the range for the 900MHz band could have adverse effects as a result of spectrum lying fallow;
 - (c) Ofcom is right to say that it must form a view as to the level of ALF in its statement – we do not reject that proposition at all;
 - (d) But that proposition does not enable Ofcom to say that it is unable to conduct a full impact analysis and do little more than what is contained in Annex 5 on the basis that the Direction precludes it from so doing;
 - (e) As previously noted, that approach reflects a continuing error in law about the Direction and is not what is clearly implied by Ofcom's own acknowledgements about uncertainty and asymmetry of risk;
 - (f) Ofcom's duty – when faced with a potential range of values – is to stress test which value is most apt to attain its duties and obligations.
- 4.3 As Vodafone pointed out in its January submission, an impact assessment is the obvious (and correct) way to do this.
- 4.4 This section 4 discusses the consequences and context of Ofcom's decision not to conduct an impact assessment.²⁶

Impact assessments

- 4.5 An impact assessment is a statement setting out how, in Ofcom's opinion, the performance of their general duties (those duties set by section 3 CA03) is secured or furthered by or in relation to what they propose to do.²⁷ The role of regulatory impact assessment in decision-making is widely-recognised as critical to the proper exercise of authority and to assist in avoiding regulatory error.
- 4.6 The minimum legal requirement is that Ofcom must conduct an impact assessment in relation to matters that are 'important', unless urgency makes that impractical or inappropriate.²⁸ Beyond this minimum requirement, Ofcom has adopted a policy that it will undertake an impact assessment in significant projects in any event. This policy

²⁶ This section, and this submission generally, is for the purpose of assisting Ofcom in formulating its ALF proposals and is made without prejudice to Vodafone's position with respect to Ofcom's decision not to undertake an impact assessment. Vodafone's position in respect of that decision remains reserved in all respects.

²⁷ Section 7(4) CA03.

²⁸ Section 7(1) CA03.

has been adopted because Ofcom recognises that undertaking an impact assessment leads to (as Ofcom titled its guidelines on the subject) 'better policy-making'.

- 4.7 Ofcom's statement in relation to its general policy when setting spectrum licence fees is an unremarkable example of the statement that Ofcom generally makes on the subject of impact assessments:

*2.10 We are required to carry out an impact assessment where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. **However, as a matter of policy, we are committed to carrying out impact assessments in relation to the great majority of our policy decisions.** For further information about our approach to impact assessments, see the guidelines, 'Better policy-making: Ofcom's approach to impact assessment', which are on our website.²⁹*

Ofcom's decision

- 4.8 Ofcom accepts that revising ALF is a matter that is 'important' and therefore, Ofcom is obliged to undertake an impact assessment in relation to ALF unless they decide that it is not necessary to do so.
- 4.9 Unlike other material decisions, Ofcom's decision is not set out in a stand-alone document but is set out in a single paragraph of Ofcom's Further Consultation. That decision is, in full (and read in context):

1.42 In response to our October 2013 consultation, a number of stakeholders said that we should carry out a full impact assessment of our proposals for revising ALFs. In essence, their view was that we should not revise ALFs to reflect full market value unless we could demonstrate that taking this approach to setting ALFs (and the specific levels of ALF that we propose) was necessary to promote efficient use of spectrum, and that the potential benefits in terms of spectrum efficiency would outweigh any potential adverse effects on consumer prices, investment in infrastructure, innovation and competition. They considered that unless we did carry out such an impact assessment any decision we made would be unlawful.

*1.43 We do not agree with this view. **We have been directed by the Government to revise ALFs to reflect full market value, and we are required to implement that direction. We do not have any discretion to decide whether or not to set ALFs at full market value. For this reason, we consider it is unnecessary for us to carry out an impact assessment of the type argued for by stakeholders (and to this extent this is a statement for the purposes of section 7(3)(b) of the Communications Act 2003).***

1.44 In implementing the Government Direction, we have considered the impact in those areas where we do have discretion and are exercising regulatory judgment in light of the evidence available to us and our statutory

²⁹ *Spectrum Pricing: A framework for setting cost based fees Including proposals for licence fees for DTT multiplex services issued under the Wireless Telegraphy Act 2006, published 13 September 2013.*

duties. We did conduct a focussed impact assessment in respect of these aspects in our October 2013 consultation. In particular, we assessed whether there was an asymmetric risk of inefficient use of spectrum from inadvertently setting ALFs below or above market value. This document contains our updated views, in light of responses, on certain aspects of how we intend to fulfil the requirements of the Government Direction including in particular a revised assessment of the asymmetry of risk. Our revised assessment, in light of the changes in our approach since the October 2013 consultation, is set out above and in Annex 5.

- 4.10 Ofcom's decision appears to be that the degree of discretion afforded to it in giving effect to the Direction is limited to a single question, being the question of whether the risk of setting ALFs higher or lower than the full market value is symmetric. Ofcom therefore seems to have opted to pursue both arms of section 7(3) in part: Ofcom has both undertaken a limited impact assessment as set out in Annex 5 of the Further Consultation and decided that any further impact assessment is unnecessary.
- 4.11 Section 1.42 does not accurately reflect the position put in submissions to Ofcom (at least by Vodafone). Vodafone does not argue that Ofcom should '*not revise ALFs ... unless [Ofcom] could demonstrate that this was necessary to promote efficient use of spectrum, and that the potential benefits in terms of spectrum efficiency would outweigh any potential adverse effects on consumer prices, investment in infrastructure, innovation and competition.*' Ofcom's mis-reading of the submissions implies that stakeholders including Vodafone were arguing that Ofcom set aside the Direction and only revise ALFs to the extent that it could see a case for doing so in light of its general duties in any event – and that an impact assessment was necessary to establish the case for such action.
- 4.12 In fact, Vodafone's submission (which remains its position) is that an impact assessment is necessary to inform the exercise of Ofcom's discretion in giving effect to the Direction. Equally critical is Ofcom's view of the objective or purpose it has in mind in setting ALFs.³⁰ This assessment should be undertaken precisely to enable Ofcom to undertake the steps it has no discretion not to take. If there is an extent to which the actions that Ofcom are obliged to take have a harmful impact, Ofcom's over-lapping duties require that tension to be addressed and if, possible, resolved – not ignored.
- 4.13 The following text, reproduced from Vodafone's January 2014 submission, illustrates Ofcom's selective reading of the point, which does not exclude that Ofcom may be compelled to a large extent by the operation of the Direction:

5.98 Ofcom's impact assessment should consider:

5.98.1 What impact their proposals have on consumers, directly and indirectly;

5.98.2 What impact their proposals have on other affected stakeholders;

³⁰ See Vodafone's January 2014 submission, e.g. section 5.

5.98.3 *Whether their proposals are necessary and objectively justifiable to promote competition; and*

5.98.4 *The effect of their proposals on regulatory certainty (particularly in light of section 2 of the Direction).*

5.99 *It is, of course, possible that Ofcom may have formed the view that the proposals do not advance, or in fact hinder, any other statutory purpose or objective, but are lawfully required to be implemented in any event by virtue of the Direction. However, there is simply no evidence disclosed to stakeholders that Ofcom has undertaken this assessment or reached any conclusions as to the direction, scope or magnitude of any impacts on consumers or operators (positive or negative).*

5.100 *An important reason for providing an impact assessment is that it ensures that Ofcom properly analyses the effects and impacts of a range of prices. By consulting on a single ALF price proposal plucked from the ether, Ofcom does nothing to refute the concern that it has failed to turn its mind to a range of impacts and effects which would have required it to properly understand the state of competition in the spectrum market and effects on consumers from various options.*

- 4.14 Ofcom's position is that it does not need to conduct an impact assessment of the type contemplated by section 7 CA03 and its guidelines (or as Ofcom characterise it, '*of the type argued for by stakeholders*'). In particular, it does not need to consider (as required under section 7(4)) '*how, in OFCOM's opinion, the performance of their general duties (within the meaning of section 3) is secured or furthered by or in relation to what they propose.*'
- 4.15 Ofcom accepts that it should undertake (and considers it has undertaken) a more limited (or 'focussed') impact assessment to guide the discretion that it considers that it does have. This limited impact assessment was initially as set out in the October 2013 consultation, but Ofcom no longer holds to that reasoning and relies on a revised version of that limited impact assessment as set out in the Further Consultation in sections preceding 1.44 and in Annex 5. The scope of that assessment is limited to a single issue, which is '*whether there is an asymmetric risk of inefficient use of spectrum from inadvertently setting ALFs below or above market value*'.³¹
- 4.16 There are a number of errors of law evident in this position:
- (a) Ofcom's approach misconstrues section 7, which does not provide for a distinction between an impact assessment and a 'focussed' impact assessment of the type proposed by Ofcom. Ofcom is required under section 7 to determine whether or not it is required to conduct an impact assessment. If it decides not to conduct an impact assessment, then it must explain its reasons. If it does decide to conduct an impact assessment (regardless of the degree of 'focus' involved), section 7(4) requires that the impact assessment must set out the link between the impact of Ofcom's proposals and the performance of Ofcom's duties.

³¹ Further Consultation, paragraph A5.1.

- (b) Viewed in that light, Ofcom's 'focussed' impact assessment set out in Annex 5 is insufficient to discharge Ofcom's duties under section 7, even in relation to the narrowly-scoped area it covers (the question of asymmetry of risk associated with ALFs being based on higher or lower estimates of market value). Although Ofcom has wide discretion as to the form and nature of an impact assessment (as provided under section 7(5)), that discretion is not unbounded; an impact assessment must still meet the basic requirement set out in section 7(4). The reasoning in Annex 5 does not assess the impact of Ofcom's proposals and consider how those impacts could affect the performance of its general duties – in particular, Ofcom fails to assess how its proposals might affect the interests of consumers and on spectrum efficiency.
- (c) An impact assessment is necessary because, contrary to Ofcom's view, it does have statutory purposes that it must attain specifically in giving effect to the Direction (section 5 WTA06, and section 2 of the Direction). Even if these purposes entirely eclipse Ofcom's general duties, the only means that Ofcom has to determine whether or not a particular course of action is proportionate to achieve these purposes is an assessment of the impact of those proposals. Without an impact assessment in light of a particular purpose or objective, Ofcom has not equipped itself to assess whether a decision to set ALFs is consistent with Ofcom's duties.

4.17 In any event, Ofcom's rationale for its decision not to conduct an impact assessment under section 7(3)(b) is manifestly inadequate, lacking in sufficiency and transparency. That reasoning, in full, is that '*[Ofcom has] been directed by the Government to revise ALFs to reflect full market value, and we are required to implement that direction. We do not have any discretion to decide whether or not to set ALFs at full market value*'.

4.18 As addressed in section 2, and Annex 2 of this submission, Ofcom's claim that in revising ALFs it is not exercising discretion to a material extent seems inconsistent with the evidence. It is also a misconstruction of the Direction. Vodafone relies on its previous submissions, which remain unaddressed, in its January 2014 submission concerning the correct construction of the Direction.

4.19 Ofcom's view that 'we have no discretion' therefore:

- (a) is contradicted on the face of the Direction, which sets out the purposes for which Ofcom should act when fulfilling the terms of the Direction. The need to properly give effect to these purposes requires Ofcom to assess the impact of its proposals in order to give effect to section 5 WTA06; and
- (b) is contradicted by Ofcom's own reasoning in the consultation, which makes extensive reference to the exercise of discretion and regulatory judgment. This judgment is not limited to the issue considered in section 5, but applies across a range of aspects of Ofcom's decision. Like other regulatory processes, the revising of ALFs to reflect full market value involves a number of steps, each of which involves the exercise of discretion. In other contexts, the Tribunal has pointed out that separating such steps and consulting of each of them separately

may be better than simply compounding the uncertainties in a single unitary decision.³² Ofcom's view that each of these discretionary steps is mechanistically or deterministically set by the Direction is an error of law.

Comparing Ofcom's approach to ALF with other analogous proceedings

4.20 It is not unusual for Ofcom to exercise its powers in circumstances where some aspects of decision-making are discretionary, and other aspects of decision-making are legally constrained. Indeed, most of Ofcom's decisions include some elements that are set by legal instruments outside Ofcom's control (such as the Directives, Recommendations, various UK statutory instruments such as the Direction, and so on).

4.21 There is therefore a body of practice in analogous circumstances that can be compared with Ofcom's approach in revising ALFs. This exercise illustrates the unorthodox nature of Ofcom's approach, and the inconsistency of the approach taken in relation to ALF and other analogous cases (see Table 1).

³² Vodafone v Ofcom [2008] CAT 22 (MNP) at 159. The Tribunal noted, in remitting back the issue of MNP back to Ofcom for consideration, that 'OFCOM should seek the fresh views of the industry on the issue of altering the current arrangements in the UK for fixed and mobile porting, on the basis of appropriate evidence and analysis in light of the findings set out in this judgment. **The Tribunal further considers that a staged approach to decision making in a matter of such complexity may be advantageous.** Such an approach would enable information gathered from earlier stages to provide the basis for CBA-based decisions upon whether to proceed to the next stage(s), although by this time matters already proceeding may well enable reduced uncertainty with respect to certain factors and allow for measures of previously unknown inputs to be quantified and incorporated in OFCOM's revised analysis.' Emphasis added.

Table 1: Comparison of ALF revision with other tasks where under the CRF Ofcom has no discretion whether to undertake that task

Task	Statutory basis	No discretion	Discretion	Ofcom's approach
Resolve dispute	If dispute falls within statutory criteria, Ofcom 'must accept' dispute for resolution	<ul style="list-style-type: none"> Whether to resolve the dispute 	<ul style="list-style-type: none"> What framework or principles to adopt in resolving the dispute What determination to make to resolve the dispute 	Extensive recourse to Ofcom's duties
Determine if a market is effectively competitive and set SMP conditions	CRF requires Ofcom to review a market on recommended list	<ul style="list-style-type: none"> Whether to conduct a market review 	<ul style="list-style-type: none"> Whether to make a market power determination What remedies to set Phasing in of remedy (glide-path) 	Extensive recourse to Ofcom's duties Impact assessment undertaken
Set a charge control	If it sets price control, Ofcom must do so in accordance with statutory provisions	<ul style="list-style-type: none"> Whether or not to set charges at cost-oriented rates 	<ul style="list-style-type: none"> What measure of cost to use (forward-looking vs historic; LRIC+ vs pure LRIC) What cost method to use (benchmarking, cost modelling) What regulated charges to set 	Extensive recourse to Ofcom's duties Impact assessment undertaken
Set charges for number portability		<ul style="list-style-type: none"> Whether to set charges at cost-oriented rates 	<ul style="list-style-type: none"> What approach to take to assessing 'cost' (see Mobistar case) What 'national measure' (ie the mechanism) used to set charges 	Extensive recourse to Ofcom's duties
Conduct combined auction	Sections 8 and 9 of the Direction	<ul style="list-style-type: none"> Whether to conduct the combined auction 	<ul style="list-style-type: none"> Detailed design of the auction Whether to impose spectrum ceilings/floors or other interventions to shape auction outcomes Whether to set coverage obligations What reserve price to set 	Extensive impact assessment and reference to Ofcom's statutory duties throughout its decision.
Revised spectrum licence fees for 900 and 1800 MHz spectrum	Section 6 of the Direction	<ul style="list-style-type: none"> Whether to revise spectrum licence fees to reflect full market value 	<ul style="list-style-type: none"> What approach to take to assessing 'full market value' How to assess 'full market value' taking into account UK auction results (ASM, LRP, marginal bidder analysis, etc.) How to take into account other evidence as to 'full market value' (international benchmarking, cost modelling, other) What spectrum fees to set 	<i>"We do not have any discretion to decide whether or not to set ALFs at full market value. For this reason, we consider it is unnecessary for us to carry out an impact assessment ..."</i>

4.22 Each row of Table 1 represents a task that Ofcom is required to undertake – that is, a task where, to some extent or at least in part, Ofcom has ‘no discretion’. As noted in the table, each of those tasks then falls to be undertaken by Ofcom in accordance with the wider engagement of their statutory duties – and Ofcom does so. In each other case, including in the case of the design of the combined auction, Ofcom has considered that an impact assessment is required and it has undertaken that assessment.

Donor Conveyance Charges

4.23 The example of cost-oriented charges in relation to mobile number portability (for example, Ofcom’s recent action to set the ‘donor conveyance charge’ or ‘DCC’) is instructive because it is a case where Ofcom is constrained as to the high-level nature of the calculation to be undertaken: it does not have discretion as to whether or not those charges are to be cost-oriented. However, Ofcom has discretion as to the method used to establish those rates (given that ‘cost-orientation’, like ‘full market value’, is a term that requires further definition to be implemented in a specific instance) and also the nature of the ‘national measure’ to be adopted to achieve this outcome.

4.24 In choosing the method and approach to cost-orientation in relation to DCC charges, Ofcom explicitly outlined the need to be consistent across different areas of policy work, noting that:

... in order to give full and proper consideration to the appropriate cost standard to be used in setting porting charges generally, we should (amongst other things) give careful consideration to the cost standards we have used elsewhere such as the regulation of call termination markets and interconnection.³³

4.25 In choosing the measure that it would adopt, Ofcom’s approach in DCC explicitly built in the need to preserve the wider framework of protections afforded to stakeholders, notwithstanding that Ofcom did not have any discretion whether to set cost-oriented rates or not. Ofcom saw the approach it adopted (a direction under GC18.5) as being desirable in part on the following basis:

We also consider that a direction under GC18.5 is an appropriate measure to use in these particular circumstances as it will ensure that our proposals are subject to the statutory safeguards set out in sections 49 to 49C of the Act. In particular, these sections impose a requirement for consultation where the proposal would have a significant impact on the market and requirements that the giving of the direction is proportionate, not unduly discriminatory and transparent in relation to what it is intended to achieve.

4.26 This is in contrast to Ofcom’s approach in ALF, which is to adopt an approach that removes the equivalent safeguards afforded to Vodafone and other spectrum licensees.

³³ DCC statement, February 2014, paragraph 4.6.

4.27 Ofcom's final DCC decision illustrates the combination of discretionary and non-discretionary elements involved in its decision-making, and that where it was left discretion to do so, it sought to closely align its decision with the wider body of decisions taken under the CRF (in the interests of consistency) and to take into account the impact on a wide set of statutory duties that might be affected by its decision:

5.13 As set out in Section 3, we have a duty under Article 30(2) USD to ensure that pricing between operators/service providers related to the provision of number portability is cost-oriented. We may also set a maximum DCC on an ex ante, industry-wide basis using an average efficient cost model, and consider that a direction under GC18.5(a)(ii) is an appropriate means of doing so.

5.14 We consider that the direction set out in Annex 2 satisfies section 49(2) of the Act as it is:

5.14.1 not unduly discriminatory, in that it would apply to all CPs that levy a charge for the onward conveyance of a call to a ported mobile number;

5.14.2 proportionate to what it is intended to achieve, in that the direction ensures that charges for mobile portability remain cost-oriented. In particular, we refrained from regulatory intervention for a period of time before making this direction in order to allow MCPs to enter into bilateral commercial negotiations with regard to revised DCC(s); and

5.14.3 transparent in what it is intended to achieve, in that the direction is explained in this consultation document and set out in full in Annex 2.

*5.15 We also consider that the direction is consistent with our principal duty under section 3 of the Act, and the Community requirements set out in section 4 of the Act. **Ensuring that DCCs are capped at a cost oriented level serves to promote effective competition, and through this furthers the interests of consumers.** We have also had regard, as required by section 3(3) of the Act, to the principle that regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and to other principles of best regulatory practice. In particular, we have sought to ensure that our modelling approach is consistent (insofar as possible) with that used in the 2007 Determinations and we have sought to provide a degree of consistency and regulatory certainty going forward by setting the DCC until March 2016.*

4.28 Unlike the corresponding statements in the first ALF consultation, these statements are backed up by reasoning (in the decision) as to the impact of Ofcom's DCC decision and therefore represent a discharging of Ofcom's relevant duties. For example, Ofcom's ALF proposals make no statement at all explaining any link between setting ALFs and the objectives set under the Direction or the impact on effective competition

or the interests of consumers, beyond the bland and unsupported statements in the first consultation.

The combined auction

4.29 Returning to Table 1, the comparison with Ofcom's approach to the combined auction is particularly apt, because in that case, Ofcom was giving effect to a different provision of the Direction but the statutory framework is in all other respects identical. In its decision to set the rules for the combined auction, Ofcom explained that (under the heading 'Impact Assessment'):

Impact assessment

2.6 This Statement, together with its annexes, as a whole comprises an impact assessment, as defined in section 7 of the Communications Act 2003. A summary of the impact assessment is set out in Annex 1.

2.7 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the Communications Act 2003, which means that generally Ofcom has to carry out impact assessments where its proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out and publishing impact assessments in relation to the great majority of its policy decisions. For further information, see our guidelines, 'Better policy-making: Ofcom's approach to impact assessment'.

4.30 Annex 1 of that Statement is a table setting out the various statutory objectives and the way in which Ofcom's assessment of the impacts of its proposals have been taken into account in the various parts of Ofcom's decision.

4.31 Ofcom's statement of its approach to combining its relevant statutory duties with the requirements set on it by the Direction encapsulates perfectly the approach that Vodafone considers that Ofcom ought to adopt in relation to ALF:

Application of our duties to the Auction

3.47 Taking into account each of the above duties and the relevant facts and circumstances, we consider that our principal duty to further the interests of citizens, and the interests of consumers where appropriate by promoting competition, is of particular importance to the Auction.

3.48 We also consider that our duties relating to

3.48.1 the optimal use for wireless telegraphy of the electro-magnetic spectrum;

3.48.2 the desirability of encouraging investment and innovation;

3.48.3 the desirability of encouraging the availability and use of high speed data transfer services throughout the United Kingdom; and

3.48.4 having regard to the interests of consumers in respect of choice, price, quality of service and value for money;

are particularly relevant.

3.49 In carrying out our competition assessment, in particular, we have taken account of the need for our proposals to be objectively justifiable, not unduly discriminatory, transparent, and proportionate. As we set out in this document, there are uncertainties surrounding a number of key factors which are relevant to our competition assessment. In light of those uncertainties, we have sought to explain why we consider that the decisions that we make are appropriate in light of our aims and duties, and comprise the least restrictive measures which we consider are reasonably capable of meeting the aims that we have identified as being of most importance.

3.50 Further specific duties are relevant to individual elements of the Auction, and we address them at the relevant sections of this document as they arise.

- 4.32 Ofcom has made a similar statement in the initial consultation on ALFs, but without any of justification or reasoning – it was simply a statement of Ofcom’s view and is insufficient to discharge Ofcom’s duties to give consideration to these factors.³⁴ This compares starkly with the approach taken to the auction, where at every stage, Ofcom appears to have sought to use its regulatory duties and the impact of its proposals to guide in the exercise of the discretion left to it in giving effect to that section of the Direction.
- 4.33 Vodafone struggles to identify any basis on which Ofcom ought to have such a radically different approach to ALFs as to the design of the 4G auction.

³⁴ See also Vodafone January 2014 submission.

5. Market conditions likely to be prevailing in a ‘well-functioning market’

- 5.1 This section asks: how should Ofcom take into account the role of regulation in a future market for spectrum? In particular, given that Ofcom’s definition of ‘full market value’ draws on the notion of a ‘well-functioning market’ – what, if anything, should Ofcom assume about its own role in that future well-functioning market.
- 5.2 It is not possible (as far as Vodafone can see) for Ofcom to take a decision to revise ALFs without taking some view, even if only by implication, about Ofcom’s future actions and role. This is not a new problem; in at least one other context – setting rules for access and interconnection in a market review – Ofcom has a similar challenge, which is how it ought to account for the future impact of regulation in a forward-looking view of market events.
- 5.3 The assessment of full market value in the context of ALFs is distinguishable from the forward-looking assessment of market conditions for the purpose of considering significant market power. In the case of SMP, it is appropriate to *ignore* the operation of other parts of the regulatory regime, in order to expose the underlying concerns with competition in the market under review.
- 5.4 That is, in that context, a conservative approach, since it does not assume that one part of the regulatory regime will address a problem (SMP) that might otherwise not be dealt with properly. In the context of ALF, this logic runs in the opposite direction: to ignore the operation of the regulatory regime increases, not decreases, the risks of regulatory error.
- 5.5 The closest analogy for the legal task that Ofcom faces in considering the ‘well-functioning market’ for spectrum that informs its view on ALFs may be the building of a counterfactual scenario in merger analysis. In that context, it is clear that future regulation should be taken into account, even if its operation is uncertain:

*The description of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable, enabling the Authorities to predict with some confidence. The foreseeable period can sometimes be relatively short. The Authorities may still consider the effects of the merger in the context of an event or circumstance occurring even if that event or circumstance is not sufficiently certain to include in the counterfactual. **Future changes in market conditions, such as regulation or market liberalisation, are often addressed as part of the Authorities’ competitive assessment.***

A counterfactual cannot be constructed that involves violations of competition law, e.g. a cartel.³⁵

³⁵ CMA Merger Guidelines at paragraph 4.3.2 and 4.3.3.

- 5.6 Thus, Ofcom's analysis, by ignoring the restrictions that apply on spectrum trades (including on EE specifically or in general) means that 'full market values' can reach unrealistic values that could only be realised if there were a catastrophic failure of the regulatory process. Particularly in light of Ofcom's conclusion that the greatest degree of risk is associated with setting ALFs too high, not too low, this lack of grounding in reality defeats the substantive objective, which is to revise ALFs to reflect full market value.

Spectrum caps in the 4G auction

- 5.7 It is clear that Ofcom's reasoning and views on competition in the mobile market in relation to the 4G auction form part of Ofcom's reasoning in relation to ALF. This is not surprising given the close relationship between those processes and their common grounding in law in that both give effect to different elements of a single statutory intervention (the Direction). Ofcom notes in the First Consultation that:

*We have considered evidence from stakeholders, including responses to the First Competition Assessment and the Second Competition Assessment, as to the different technical and commercial characteristics of spectrum bands, and the implications of these differences for market value. **We have also considered the implications of Ofcom's technical modelling and policy conclusions in our competition assessment in advance of the 4G Auction (the July 2012 statement), and publicly available results from technical models of network costs.***³⁶

- 5.8 It is important to be clear about the context within which spectrum caps were set in the auction. Ofcom's 4G auction statement set out a sequence of decisions that were intended to give effect to Ofcom's statutory duty to promote competition. Those decisions were, in summary:

- *UK consumers will be likely to benefit from better services at lower prices in future if following the Auction there continue to be at least four credible national wholesalers of mobile services, Therefore, we would be concerned if as a result of the Auction fewer operators had access to sufficient spectrum to compete credibly at the wholesale level in the future than is currently the case in the UK;*
- *it is likely that this would be the case if neither Hutchison 3G UK (H3G) nor a new entrant acquires at least a minimum amount of spectrum in the Auction. Absent intervention, there is a material risk that neither H3G nor a new entrant would acquire this minimum amount of spectrum in the Auction;*
- *given the nature and extent of their current spectrum holdings, we do not have the same level of concern in regard to Everything Everywhere, Telefónica or Vodafone, even though they may well be able to offer better or a wider range of services and compete more aggressively if they acquire additional spectrum through the Auction;*

³⁶ First consultation at paragraph 4.10 and see also the references to the First and Second Competition Assessment in Ofcom's substantive reasoning (e.g. at paragraph 4.41). Emphasis added.

- *therefore it is in our view appropriate to reserve some of the available spectrum in the Auction for a fourth national wholesaler, by which we mean a bidder other than Everything Everywhere, Telefónica or Vodafone;*
- *bidders for the reserved spectrum have to compete with each other, but provided that there is at least one such bidder that is willing to pay the reserve price for this spectrum, that bidder is guaranteed to win it. The exact quantities of spectrum that we consider to be proportionate to reserve are set out below;*
- *because of the level and nature of their current spectrum holdings, and/or the much lower risk that these national wholesalers would fail to acquire further spectrum in the Auction, we do not consider it necessary to reserve any spectrum for Everything Everywhere, Telefónica or Vodafone;*
- *we also consider that it would be appropriate and proportionate to impose limits on the amounts of spectrum that each bidder can acquire in the Auction, such that their overall holdings of 'mobile spectrum' in general, and sub-1GHz 'mobile spectrum' in particular, do not exceed certain safeguard caps. **This is in order to mitigate the risk of highly asymmetric spectrum holdings after the Auction leading to lower competitive intensity.**³⁷*

5.9 These caps included an overall cap of 2 x 105 MHz and a sub-1 GHz cap of 2 x 27.5 MHz of spectrum held by any one licensee.

5.10 Ofcom identified five possible circumstances under which harm to competition could arise from the auction:

If one or more credible national wholesalers does not have:

- *sub-1 GHz spectrum, which is spectrum that is not currently held by Everything Everywhere, H3G or a new entrant;*
- *2x15 MHz in a contiguous block for LTE, which is spectrum that is not currently held by Telefónica, Vodafone, H3G or a new entrant;*
- *other LTE advantages (e.g. better latency) - spectrum providing an early route to LTE is not currently held by Telefónica, Vodafone, H3G or a new entrant; or*
- *enough spectrum for capacity and average data rates for service and customer segments with especially high demand for this quality dimension, which is a risk with the current spectrum holdings of H3G or a new entrant and also Telefónica and Vodafone to a lesser extent; or*

If one competitor has a very large share of spectrum.

5.11 It is this final concern – one competitor accumulating a very large share of spectrum (whether of all spectrum suitable for mobile, or of sub 1-GHz spectrum) – that is

³⁷ Ofcom 4G auction statement at paragraph 1.10. Emphasis added.

particularly relevant in setting the spectrum caps in the auction. Ofcom is clear that it continues to rely on this assessment to inform its decision on ALF.

5.12 Setting to one side Vodafone's concerns about Ofcom doing so, that implies that the five sources of harm to competition that Ofcom had in mind in setting the auction rules remain relevant for the purposes of setting ALF.

5.13 At a minimum this suggests that Ofcom's decision on ALF ought to take into account Ofcom's views as to the state of competition in the mobile market and the conditions necessary to sustain effective competition. It also implies that where Ofcom has formed a view on the evidence gathered in Ofcom's competition assessment, it will take a decision in relation to ALF that takes into account that Ofcom has undertaken that assessment and the views in the 4G auction statement about competition in mobile will (in the absence of evidence to the contrary) inform Ofcom's predictions as to the future position it will take.

5.14 As their name suggests, Ofcom's reasoning in applying the safeguard caps was that these caps would serve as a relatively less intrusive measure than other ways of restricting access to spectrum, but that the case for these safeguard caps was robust across a wide range of scenarios:

4.238 We also do not believe we should disregard the other potential competition concerns [i.e. separate from those addressed by reserving spectrum to ensure four national wholesalers] completely and have decided to impose safeguard caps on both sub-1 GHz and overall spectrum as a way to mitigate some of them. We consider that the costs and risks associated with these caps are likely to be low as they do not tightly prescribe what bidders may win. As such, we consider them to be proportionate.

5.15 The case for safeguard caps in the future may be equally straightforward – and, given the outcome of the Auction by which EE acquired more core mobile spectrum than any other operator, there is certainly no reasonable grounds (on Ofcom's own reasoning) for believing that the case for these safeguard caps has receded or faded away. Unless and until Ofcom has a body of evidence that supports it reaching a different view, the stance adopted in the auction is the strongest signal of Ofcom's likely framework for considering whether such caps ought to limit scope for any future spectrum transfer.

5.16 This does not mean that Ofcom ought to fetter its discretion by deciding now whether or not EE would be permitted to purchase 900 MHz spectrum (and in fact, Ofcom could not do so lawfully). But it does suggest that it would not be reasonable to exclude the possibility that a spectrum cap may be applicable. In other words, what is excluded (because it would be inconsistent with the decision taken in relation to the 4G auction) is an approach by Ofcom that assumes that these concerns will have *no* role to play in future spectrum dealings.

5.17 Yet that is *precisely* what Ofcom proposes to do. In the Further Consultation, Ofcom expressly adopts a position that assumes, for the purposes of ALF, that no spectrum cap would apply:

2.58 The overall spectrum cap only formally applied at the time of the 4G auction. On a forward-looking basis as more mobile spectrum becomes available (e.g. 2.3 GHz and 3.4 GHz bands), we would not expect EE to be precluded from acquiring some more spectrum. To put the point starkly, treating the overall spectrum cap in the 4G auction as binding on a forward-looking basis would imply that EE would not be permitted to acquire any spectrum in the auction for the 190 MHz of spectrum in the 2.3 GHz and 3.4 GHz bands planned for 2015/16. Or, more directly relevant for this document, it would also imply that EE would not be permitted to acquire any 900 MHz spectrum (without also relinquishing an equal amount of spectrum in other bands of spectrum that it currently holds). In our view, it would not be a reasonable assumption for the purpose of ALF to restrict EE only to its current overall spectrum holdings, given that more spectrum will soon be available for mobile use.

5.18 This reasoning suffers from a number of problems:

- (a) In relation to consideration of 900 MHz spectrum, the availability of non-harmonised, non-core spectrum at higher bands (2.3 GHz and 3.4 GHz) and the terms under which that spectrum might be auctioned is not relevant.
- (b) Ofcom errs in combining the considerations concerning acquisition of 2.3 and 3.4 GHz spectrum with the (separate and different) considerations which may apply to EE's acquisition of 900 MHz into a single premise – that Ofcom would need to assume a future policy '*to restrict EE only to its current overall spectrum holdings, given that more spectrum will soon be available for mobile use*'.
- (c) Regardless of whether or not it is a reasonable assumption that EE would be restricted from acquiring *any* spectrum (a question that does not seem to Vodafone to arise, and about which Vodafone makes no submission), it is far from self-evident that it would be an unreasonable assumption that EE could not acquire 900 MHz spectrum. After all:
 - (1) Under the rules set in Ofcom's 4G auction statement, EE was restricted in its acquisition of 800 MHz spectrum in the auction (or 900 MHz spectrum, had that spectrum been available in the auction) above the safeguard cap;
 - (2) Revised ALFs are being set by Ofcom in a way that is intended to leave operators indifferent as to whether they acquired spectrum at auction (and hence pay market value as revealed in that process) or pay ALF set by Ofcom. If Ofcom's approach to the setting of ALF assumes a set of market conditions that are radically different to those prevailing in the auction, this objective is defeated; and
 - (3) Any future cap is likely to focus not only on the total amount of spectrum held but also on the question of whether the spectrum in question is or is not a 'core' mobile band.

5.19 Ofcom, in any event, has a clear and well-established policy that it will seek to prevent harm to competition arising through spectrum trades. There is no reasonable basis for

Ofcom ignoring the likely impact on that policy on the future market conditions faced by existing licensees.³⁸

- 5.20 In those circumstances, Ofcom's position seems to be an extreme view of the likely conditions that would prevail in a 'well-functioning market'. It is certainly not a conservative view – particularly given that the practical effect of ignoring the possibility of future spectrum caps (or restrictions on trading) is to hypothesise 'market values' that are no longer limited to amounts that bidders were actually prepared to pay for equivalent rights in the auction.
- 5.21 Ofcom is right to point out that in law, it cannot fetter its discretion as to the future competitive assessment of any given spectrum trade or release. But nor ought it take the opposite approach and assume (contrary to its established policy and statutory duties) that it will *never* intervene in relation to such trades. A more realistic and plausible assumption is that such interventions will have some effect on the 'full market value' of spectrum and to take this into account in reaching their view as to the revised ALF.
- 5.22 To resolve this matter, the simplest and most effective way to take this constraint into effect is to apply a view that is equivalent to that applied at the time of the auction. This would mean applying a marginal bidder analysis which is based only upon permitted bids under the auction rules and this is consistent with the overall policy approach (of identifying ALFs that leave ALF-spectrum licensees in the same position as they would have been had their spectrum been acquired in the auction).

³⁸ See, for example, Ofcom's Spectrum Management Policy Statement at paragraph 1.12. Ofcom notes in that Statement that '*regulation may be required to prevent the concentration of key spectrum assets causing competition concerns in downstream markets. For example, we carried out an extensive competition assessment of the mobile market to decide whether to put in place caps on the spectrum that existing players in the market could win in the 4G auction of spectrum at 800 MHz and 2.6 GHz.*'

6. Phasing in ALFs

- 6.1 Vodafone pointed out in its earlier submission that Ofcom's proposal not to phase in any increase in ALFs was unjustified and that Ofcom's consideration of the issue was not sufficient to address the very significant implications of Ofcom's proposals.
- 6.2 Vodafone therefore welcomes Ofcom's shift of approach to phase in any increases in ALF, in particular, to accommodate a switch to a Common Payment Date for all MNOs which then permits a phasing in of the increase from existing spectrum fee levels over two years.
- 6.3 However, simply splitting a single price shock into two steps, without addressing the core concern, is not sufficient to address the point. It merely emphasises the lack of any underlying framework for Ofcom to exercise its regulatory judgement.
- 6.4 The phasing-in of potentially disruptive price shocks has been described by Ofcom as 'an archetypal example of a policy judgement' requiring the consideration of the impacts of the regulator's decision on different stakeholders.³⁹
- 6.5 Although the nature and basis of a cost increase imposed on a spectrum licensee under section 12 WTA06 is in some ways different from an increase in a price regulated by an SMP condition, the fundamental question facing Ofcom is the same: should a regulatory decision that will be, in economic terms, a cost shock take effect immediately, or be phased in over time?
- 6.6 Ofcom's general policy has been to phase-in regulatory decisions affecting the cost base of the sector. This approach has been endorsed by the appellate bodies – and Ofcom has been criticised in the past for approaching these questions as matters of 'pure' discretion without some clear rationale or policy framework within which to exercise its discretion. There is no reason set out in Ofcom's proposals (and none that Vodafone can see) why a decision to increase ALFs should be approached in a different way.
- 6.7 One possible answer to this line of reasoning might be that the appellate bodies reviewing decisions taken to impose an SMP condition review the appealed decision 'on the merits', whereas any appeal of a decision to revise a spectrum licence fee would proceed by way of judicial review. This concern is misplaced, for the reasons set out in Vodafone's submission to the first consultation.
- 6.8 In other contexts, Ofcom has made strong and compelling statements in favour of the need to undertake an impact assessment to weigh up the implications of different glide-paths and period of implementation of a new policy.

³⁹ Competition Commission, 2009 MCT Determination

6.9 Ofcom has in this case decided not to undertake an impact assessment. As a result, it is not in a position to assess whether, for example, the interests of consumers are best served by a longer or a shorter transition.

6.10 Ofcom has previously been criticised for vagueness in relation to precisely this issue in the past:

5.48. While we accept that there is regulatory judgement involved in Ofcom's decision on the length of the glide path, this is not to say that Ofcom's choice is not open to challenge if, for example, the reasons given for its choice are manifestly unsound or if Ofcom has failed to adequately justify its choice between alternatives, particularly if, on the face of it, Ofcom appears to have adopted an inferior solution.⁴⁰

6.11 Here is the text from which Ofcom's reasoning in the case of ALF must be gleaned (emphasis added):

6.13 A number of respondents (including the MNOs and Prospect) argued in their responses to the October 2013 consultation that there was a case to phase in the new fee rates over time and that we should consider the impact of different lengths of phase-in on investment, notably the deployment of 4G networks. Some of the responses drew attention to other cases where increased fees have been phased in over time.

*6.14 We have considered these arguments carefully. **We are conscious that a significant period of time has passed since the Government direction was made in December 2010, and since the conclusion of the UK 4G auction in March 2013. Taking that into account, in light of these responses we think that a fair and reasonable approach for us to take is to set a common effective date as soon as practicable after the new fees regulations come into force, with a two-stage phase-in of revised ALF. This phase-in would consist of the following (abstracting from indexation for inflation for simplicity):***

- one half of the increase (from the current ALF rate to the proposed new ALF rate coming into effect on the CED; and*
- the second half of the increase becoming effective one year later (which as set out above would be the common actual payment date). From this date ALF rates would be at the proposed revised level.*

6.12 In the MCT case, Ofcom had a clear view as to where the interests of consumers lay, and used that view to inform the exercise of regulatory judgement. It simply (in the view of the CC) made an error in the exercise of that judgement as a result of, in

⁴⁰ Competition Commission, 2009 MCT Determination.

summary, inconsistency in the application of evidence of the impact of MCT proposals in different parts of the decision.

- 6.13 Vodafone is at a loss to understand how any analogous exercise of regulatory judgement can be sufficiently informed in relation to ALFs, where Ofcom has decided not to undertake an impact assessment.
- 6.14 In the event that Ofcom were considering the impacts of its proposals, then Vodafone would expect that Ofcom would need to begin by considering basic questions (consolidating Ofcom's various duties) such as:
- (a) What effect would the revised ALF proposals have on consumers?
 - (b) What effect would the revised ALF proposals have on competition? For example, does Ofcom still hold to the view, expressed to Government in 2010, that setting ALFs to reflect full market value will have very little impact on any competitive distortions between licensees in different spectrum bands?
 - (c) What effect would the revised ALF proposals have on incentives to use spectrum efficiently over time (beyond simply 'more incentive')?
 - (d) What effect would the revised ALF proposals have on investment?
 - (e) What effect would the revised ALF proposals have on innovation?
 - (f) Over what range of values might ALFs be set in each band and still reflect full market value? (With the answers to the other questions informing Ofcom's judgement as to where within that range ALFs ought to be set).
- 6.15 Ofcom, by virtue of its decision not to conduct an impact assessment, has no answers to these questions. Consequently, on the basis of Ofcom's current proposals, any decision about the period over which to phase in ALFs is simply a stab in the dark.
- 6.16 Vodafone would support a pragmatic approach – for example, phasing in ALFs over a longer period that reduced the likely negative impacts on consumers of the price increases flowing from higher ALFs. For instance, Ofcom might consider linking the phasing in of ALFs to the period of time during which Ofcom has indicated it is not minded to consider revising ALFs – that is, five years.
- 6.17 In any event, when reaching that judgement, one of Ofcom's guiding principles should be: what approach most furthers the interests of consumers? At the moment, Ofcom does not know the answer, and has decided that it will take a decision without undertaking any investigation to find out. Apart from the legal concerns with that course of action, the scope for falling into regulatory error, harming the interests of consumers, seems self-evident.
- 6.18 The only principle that does flow from the limited impact assessment that Ofcom has undertaken is that Ofcom should prefer to risk setting ALFs too low than too high – a principle that Ofcom express in terms of being 'conservative'.
- 6.19 It follows that Ofcom ought to prefer a longer period over which to phase-in ALFs over a faster transition.

6.20 Other relevant factors that Ofcom ought to consider include, at least:

- (a) Consistency with practice in other analogous decisions dealing with the mobile sector. A one-year transition to a significantly different cost base for an essential input would be very unusual in, for example, the regulation of access prices. Spectrum licence fees have a number of economic points of similarity to essential access services – it is an essential input – and the disruptive effects of a cost increase to industry are a product of the quantum of the price increase, not the rationale for allowing it to occur. In MCT, the CC opted for a 2-year transition over a 3-year transition, but this was unusual (call termination is a two-way access service provided on a reciprocal basis, for example). A closer match is with the one-way access services (such as LLU, PIA or leased lines) where Ofcom’s policy is to have prices change over the life of the market review period – generally four years or more (albeit with recent decisions imposing a glide-path over three years, reflecting the effect of the 2009 reforms to the CRF which required market reviews to be undertaken every three years – which is obviously not a relevant factor in relation to the ALF decision).
- (b) Consistency with practice in relation to other spectrum licence fee decisions. Implementation of AIP for DTT is expected to be over a 4-5 year glide-path (that is, introducing AIP from around 2020). The issues in that proceeding closely map onto the issues in ALF (see Table 2 below). There, Ofcom’s starting point that there it was appropriate to use AIP as a tool for spectrum efficiency in relation to spectrum used for broadcasting (akin to the starting point that it is required to revise ALFs so that they reflect full market value) and then considered timing issues as a distinct concern.

Table 2: Comparing Ofcom’s approach to introducing AIP for DTT to ALF

Starting point	Question remaining to be determined	Ofcom’s approach
It is appropriate to introduce AIP for broadcasting spectrum (Government/Ofcom)	What is the right period over which to implement that change?	Weigh up a range of options. ⁴¹ Consider impacts on different stakeholders. ⁴² Explain reasons for reaching that view. ⁴³
It is appropriate to revise ALFs so that they reflect full market value	What is the right period over which to implement that change?	No impact assessment is necessary

Taking its decision in 2013, Ofcom summarised its approach in the following terms, which make it clear that all of the elements missing in Ofcom’s assessment of ALF – such as identifying a clear regulatory objective and an

⁴¹ AIP consultation, paragraph 4.5.

⁴² AIP consultation, section 4.

⁴³ AIP statement, paragraph 4.2.,

assessment of the impact of different options – were adopted by Ofcom in relation to the choice of implementation path:

2.11 Accordingly, the Consultation made it clear that we were not seeking to re-address the principles behind spectrum charging for broadcasting, or the application of AIP in particular. The Consultation stated: “We see no reason to revise our approach to the principle of applying AIP, as set out in the 2007 statement”. Instead, we said the Consultation was being published in order to set out revised proposals for the implementation of charges.

*2.12 We considered first whether 2014 was the appropriate time to introduce AIP to spectrum used for national DTT. **We assessed this in light of likely changes to the international environment affecting DTT use of spectrum. We asked whether AIP would achieve its objective of delivering greater efficiency in spectrum use in the new circumstances, and whether there would be scope for broadcasters to respond effectively.***

- (c) The special characteristics of spectrum pricing are relevant to these questions – particularly the fact that spectrum pricing changes do not need to be brought in the short term to have their beneficial effects, but are designed to change the long-term incentives on spectrum users to change spectrum use to make it more efficient. Therefore, other factors weighing in favour of a shorter transition (which are relevant in the context of the access regime) do not apply in the case of spectrum policy. As Ofcom noted in the context of AIP for DTT:

1.9 It is important to understand in this context that Ofcom’s primary purpose in applying AIP is not, in general, to achieve any specific short-term change in the use of spectrum. Rather, our aim is to ensure that the holders of spectrum fully recognise the costs that their use imposes on society by holding spectrum (or seeking to acquire additional spectrum), when making decisions. We fully appreciate that many holders of spectrum are not in a position to make rapid changes to their use of spectrum in response to the application of AIP, but note that in practically every case the holders of spectrum have opportunities to change their use of spectrum in the longer term, albeit in some cases the longer term may be many years away. The use of AIP is, in our view, justified by the benefits that should materialise in the longer term, as better decisions are made in light of increased awareness and appreciation of the value of spectrum – better decisions that should lead to more efficient use of the spectrum.

Similar reasoning applies in the case of the implementation of revised ALFs, where MNOs have analogous (if perhaps somewhat weaker) constraints on their ability to use alternative spectrum (although that may change when 700MHz band frequencies become available – which could make the availability of more

spectrum a sensible trigger point for the phasing-in of revised ALFs). There is therefore no policy imperative to introduce revised ALFs in a way that creates undue harm or disruption – the policy purposes of the Direction can be achieved in a less harmful (and hence, more proportionate) way via a longer transition.

- (d) Finally, it is appropriate to consider the constraints that apply to retail contracts (including the operation of GC9) and the speed with which the market can adjust to a fresh price shock.

Annexure 1: Evidence as to discretion or judgement exercised by Ofcom in giving effect to section 6 of the Direction

The 'stage in Ofcom's reasoning' refers to the framework set out by Ofcom in Figure 1.1 on page 6 of the Further Consultation.

This analysis is not exhaustive and merely highlights some of the most significant judgements that fall to Ofcom to be resolved exercising their regulatory discretion. This table sets out this material for the purpose of illustrating the degree of discretion and is separate from Vodafone's submissions on the merits of the views Ofcom proposes to reach on each issue. Specifically, inclusion of any text here does not imply that Vodafone agrees with or supports Ofcom's position.

Stage in Ofcom's reasoning	Issue	Text illustrative of Ofcom's exercise of discretion
Step 1 – Market value of 800MHz and 2.6GHz in the UK	Choosing a method used to derive market value	<i>2.13 In the October 2013 consultation we discussed several different methods to derive market values of the auction bands from the bids in the auction. We still consider a range of methods (indeed a wider range than previously). However, as noted above, we have revised our view on the appropriate methodology and our estimates of market values of the auction bands for the purpose of ALF in light of stakeholder responses.</i>
	Adopting a definition of 'full market value'	<i>2.9 As in the October 2013 consultation, we interpret full market value for the purpose of ALF to mean the market-clearing price in a well-functioning market, or the marginal opportunity cost of the spectrum. This is also the highest losing bid for the marginal increment of spectrum in a (competitive) auction. We also take account of adjustments which stakeholders proposed were needed (such as for a contiguity and/or coverage premium) when using the auction results as a basis for valuing the ALF bands.</i>
Step 2a - International benchmarks for 800 MHz, 900MHz, 1800MHz, 2.6 GHz	Whether to adjust international benchmark data to render it more directly comparable to the UK data	<i>3.19 Some stakeholders argued that we should adjust the auction prices to take account of country-specific factors (in addition to those set out in paragraph 3.17 above). We have considered the potential role of a range of country-specific factors in determining auction prices, in particular differences in market profitability, demand for 2G spectrum and urbanisation. For each of these factors, we have considered both the strength of arguments for considering that, in principle, the value of a spectrum band (or relative values between bands) in other countries risks being understated or overstated as an indicator of the value of spectrum in the UK, and whether such arguments are supported by the available evidence. In doing so we recognise the limitations of this evidence, particularly given the limited number of available data points (i.e. prices for each band in each country).</i>
	Whether to give greater weight to relative values than absolute values when taking into account international benchmark evidence	<i>3.20 ... in view of the considerable scope for country-specific factors to influence differences in absolute values of spectrum between countries, our analysis now focuses primarily on benchmarks that are derived using relative values between bands (see Annex 7 paragraphs A7.37 to A7.41). This is because the impact of most country-specific factors is likely to be reduced when looking at the relative value of different bands in the country concerned (in the same way the ratio between the value of 900 MHz and 800 MHz in</i>

		<p><i>the country in question is not affected by whether we use contemporaneous exchange rates or purchasing power parity to convert the auction prices into £ sterling, for example). Our assessment considers (in qualitative terms) the extent to which benchmarks that are derived from relative values might be affected by country-specific factors (see paragraphs 3.36 and 3.43 to 3.44 below).</i></p> <p><i>3.21 We continue to consider the implications of the absolute values (i.e. the European auction prices of 900 MHz and 1800 MHz bands themselves) – but only as one of the cross-checks we make on our assessment of the lump-sum values from the relative benchmarks.</i></p>
	Which comparison is the most relevant when assessing relative values	<p><i>3.22 Our revised approach is to focus on relative benchmarks, derived from the international auction prices. We therefore derive benchmark evidence points for UK values based on the measure of relativity which we consider to be the most appropriate for each of the 900 MHz and 1800 MHz bands in turn.</i></p> <p><i>3.23 For the 900 MHz band, we have focused on the relative value of 900 MHz to 800 MHz licences. We consider this is likely to be the most informative benchmark evidence for the value of 900 MHz in the UK, particularly in light of the similar underlying technical characteristics of these two bands. Therefore, for example, in Ireland we estimate the value of 900 MHz spectrum at £39.6m/MHz and the value of 800 MHz at £63.5m/MHz, so the 900 MHz value is just over 62% of the 800 MHz value. Applying this ratio to our estimate of the value of 800 MHz in the UK net of co-existence costs and without coverage obligations (£32.63m/MHz) suggests a UK value of 900 MHz spectrum of £20.3m/MHz (i.e. 62% of £32.63m).</i></p> <p><i>3.24 Turning to 1800 MHz, we consider that, in view of its technical and commercial characteristics, the market value of this band is likely to be between the values of 800 MHz and 2.6 GHz spectrum...</i></p>
	Whether to adopt the 'distance method'	<p><i>3.27 We consider this distance method to be more appropriate than the use of ratios of 1800 MHz to 800 MHz and 1800 MHz to 2.6 GHz (as in the October 2013 consultation). It focuses on the question of where the value of 1800 MHz lies between the values of 800 MHz and 2.6 GHz. We consider this to be more relevant than the ratio of 1800 MHz to either 800 MHz or to 2.6 GHz on their own. It generates a benchmark for each country using all of the information on spectrum values in these bands to do so, and it produces one (and only one) benchmark for each country.</i></p>
	Adopting a framework for using benchmarks to assess UK market value	<p><i>3.33 Having derived a set of country benchmarks based on relative values as described above, next we develop proposals for UK market value in light of this set of benchmarks. To do so, we:</i></p> <ul style="list-style-type: none"> <i>• First, group the benchmarks into tiers, according to the extent to which we consider them to be informative of UK market values. We place more weight on benchmarks in a higher tier as we regard them as providing better quality evidence as a basis for ALF.</i> <i>• Second, assess the risk that individual benchmarks may be understated or overstated estimates of market value in the UK and characterise the nature of that risk in terms of extent, scale and direction of any potential understatement or overstatement. This assessment affects our interpretation of the benchmark.</i> <i>• Third, reach a view as to the lump-sum value of 900 MHz and 1800 MHz in the UK, in light of these benchmarks, taking account of the quality and nature of each benchmark evidence point (reflecting,</i>

		<p>respectively, the tier of the evidence point and its risk of understatement or overstatement referred to above).</p> <ul style="list-style-type: none"> • Fourth, apply cross-checks to our estimates of the lump sum values for 900 MHz and 1800 MHz in UK, including calculation of an illustrative weighted average and consideration of absolute benchmarks. We also consider the 1800 MHz / 900 MHz ratio.
	Interpreting international benchmarks, given country-specific concerns	<p>3.51 In interpreting the Austrian and Irish evidence points, we note that some stakeholders suggested that strategic behaviour by bidders may have taken place, which could introduce an overstatement to our 900 MHz / 800 MHz benchmarks. We discuss these suggestions in more detail in Annex 8. As regards the direction of any potential overstatement or understatement, we consider that the strategic behaviour alleged in Ireland might lead this benchmark to be overstated, while in the Austrian case the direction of any understatement or overstatement is less clear. In our view, the available evidence is inconclusive about strategic bidding in either of these awards, and we consider that our assessment should treat the risk and scale of any such understatement or overstatement as being unknown in each case.</p> <p>3.52 In interpreting the Portugal and Spain evidence points there are reasons for considering that they might overstate market value – namely that in Portugal some 900 MHz was unsold at reserve price, while in Spain 800 MHz spectrum sold above the reserve price.⁵⁷ However, in Portugal there are also factors pointing in the opposite direction (non-contiguity of the 900 MHz lots may have reduced their value). Our view is that there is a larger risk of overstatement in the case of Spain; and that the risk of understatement or overstatement in Portugal is unknown and could be in either direction. In both cases our view is that our assessment should treat the scale of any such understatement or overstatement as unknown.</p> <p>3.53 In Denmark, we consider there is a larger risk that the benchmark is a larger understatement, due to the exclusion of the three incumbent operators as noted above. In Romania we consider there is a risk of understatement or overstatement, but that the risk and scale of any such understatement or overstatement should be treated as unknown.</p>
Step 2b - Lump Sum Value (LSV) for 900MHz and 1800 MHz in UK	Estimating the market value of 900 MHz spectrum	<p>3.55 We have two first-tier benchmarks (Austria and Ireland), of which the higher is almost double that of the lower. The average of these benchmarks is around £29.8m per MHz.</p> <p>3.56 We consider that an appropriate estimate for UK market value should be towards the lower end of the range of first-tier benchmarks because:</p> <ul style="list-style-type: none"> • We consider that we should adopt a conservative approach when interpreting the evidence; and • There is a risk that the Irish benchmark overstates the UK market value, although we treat the level of risk and the scale of potential overstatement as unknown. <p>3.57 On this basis, we consider that an appropriate estimate of UK market value would be between the average of the first tier benchmarks, and the lower of these two benchmarks, i.e. between around £20m and £30m per MHz. A figure of around £25m per MHz could be appropriate if we were solely considering first-tier benchmarks.</p> <p>3.58 We next consider second-tier benchmarks. The average of the first-tier and second-tier benchmarks</p>

		<p>is about £26m per MHz. This average includes both the Spain benchmark of £23.2m per MHz (which reflects the sale of a single block of 900 MHz spectrum sold at reserve price, and is likely to be an overstatement) and the Portugal benchmark of around £22m per MHz (for which there is a risk of understatement or overstatement - see paragraph 3.52). Adding in these benchmarks suggests that our estimate should be lower than the £25m mentioned above.</p> <p>3.59 Considering the third tier of evidence, the low Denmark benchmark is well below the Irish benchmark, while Romania is closer to the Austria benchmark. However we place considerably less weight on these third tier benchmarks for the reasons given above, and explained in Annex 8.</p> <p>3.60 On balance, we consider that £23m per MHz is an appropriate estimate of the market value of 900 MHz spectrum in UK for the purpose of setting ALF, adopting a conservative approach to interpreting the benchmark evidence. It is significantly lower than the average of the first-tier benchmarks and reflects a downward revision adjustment to take account of the second-tier benchmarks.⁵⁸ It is close to (though above) the lowest first-tier benchmark. .</p>
	<p>Estimating market value of 1800 MHz spectrum</p>	<p>3.76 We have three first-tier benchmarks, in Austria, Ireland and Italy. The highest, Austria, is around 90% higher than the lowest, Italy, while Ireland is much closer to Italy than Austria. The average of the Austria, Ireland and Italy benchmarks is £17.8m per MHz.</p> <p>3.77 We consider that an appropriate estimate for the UK market value of 1800 MHz should be towards the lower end of the range of first-tier benchmarks because:</p> <ul style="list-style-type: none"> • We consider that we should adopt a conservative approach when interpreting the evidence; • Two of the three benchmarks are at the lower end of the range, while only one is at the top; • There is a risk that the Irish benchmark overstates the UK market value, and we have categorised this as a larger risk, although the scale of potential overstatement is unknown. <p>3.78 We consider that there are stronger reasons for preferring a figure towards the lower end of the first-tier range than in the case of 900 MHz (as set out in paragraph 3.57 above), since there are two benchmarks around the lower end of the range, and there is a larger risk, rather than an unknown risk, of overstatement in Ireland.</p> <p>3.79 We consider that an appropriate estimate of UK market value would be between the average of the first tier benchmarks and the lowest benchmarks, i.e. between around £13.5m and £17.5m per MHz. We consider that a figure of around £14m per MHz could be appropriate if we were solely considering first-tier benchmarks.</p> <p>3.80 We next consider second-tier benchmarks. We note there is less consistency in the second-tier benchmarks than in the case of 900 MHz. The average of the first-tier and second-tier benchmarks is about £15m per MHz. The German benchmark is at larger risk of being a larger understatement, but it is substantially lower than £14m per MHz. The Sweden benchmark could be seen as indicating a higher value than £14m per MHz. However, the two benchmarks in the second tier have implications in different</p>

		<p>directions. Their inclusion in the second tier also indicates that we consider these benchmarks to be less informative of the UK value than the benchmarks in the first tier. Therefore, on the basis of the second-tier evidence we do not consider it appropriate to adjust the £14m per MHz figure suggested by a conservative interpretation of the first-tier benchmarks.</p> <p>3.81 All four of the third-tier benchmarks are materially lower than £14m. However, we place considerably less weight on these benchmarks for the reasons given in paragraph 3.72 above, and further explained in Annex 8.</p> <p>3.82 On balance, we consider that £14m per MHz is an appropriate estimate of the market value of 1800 MHz spectrum in the UK for the purpose of setting ALF, adopting a conservative approach to interpreting the benchmark evidence. . It is significantly lower than the average of the first-tier benchmarks and we do not consider that the second- or third-tier benchmarks provide a strong reason for a higher or lower estimate.⁶³ It is close to (though slightly above) the lowest first-tier benchmark.</p>
Step 3 - Discount rate (used for deriving annuity)	Adopting an inflation index	<p>4.7 We are now minded to use CPI as the measure of inflation in calculating ALFs, both for the purposes of (i) the discount rate that we adopt at various stages of our ALF methodology (in estimating the lump-sum value of spectrum and also in annualising such lump sums into ALF), and (ii) the way we derive the change in ALF each year in line with this measure of inflation.</p>
	Adopting a discount rate	<p>4.10 These three exercises have slightly different purposes and so, for reasons explained below, we consider that it is appropriate to apply a different discount rate for each. In summary, we propose to apply:</p> <ul style="list-style-type: none"> • The cost of debt for the purposes of deriving ALFs. This is a change from our October 2013 consultation in which we proposed to use a WACC for these purposes; • The 2011 MCT WACC, converted to a CPI-adjusted real WACC, for the purposes of adjusting licence duration. This is the same approach as in the October 2013 consultation, aside from the change in the inflation index used; and • The 2011 MCT cost of debt, converted to a CPI-adjusted real cost of debt, for adjusting benchmark auction results for the presence of annual fees. This is a change from our October 2013 consultation in which we proposed to use a WACC for these purposes.
	Adopting a tax adjustment factor	<p>4.33 We have made a number of adjustments to our modelling of the TAF [tax adjustment factor]. Rather than using the latest forecasts for corporation tax for each year between 2013/14 and 2015/16 then a constant rate of 20% thereafter, we use a flat rate of 20%. This simplifies the calculation and makes a very small difference only to the resulting ALF. We assume a CPI inflation rate of 2% (as discussed above) and (as before) amortise the lump-sum payment over 20 years. The tax adjustment is calculated from the difference in tax benefits from ALF payments compared to the amortisation tax deductions available through a lump-sum payment, converted to present values using the after-tax discount rate of 2.6% (as discussed above). The TAF is thus calculated as:</p> $TAF = 1 + \frac{PV \text{ of tax benefits of ALF} - PV \text{ of tax benefits of the amortisation of LSV}}{LSV}$ <p>4.34 We calculate that the impact of the tax adjustment is equivalent to an increase of 8% in the lump-sum</p>

		<p>value (compared to 11% in the October 2013 consultation). The full derivation of our ALF proposals incorporates a TAF of this amount.</p> <p>4.35 We are still considering whether the TAF appropriately captures the tax effects of levying ALFs, and whether there are simpler and more transparent ways of capturing such effects. An alternative, equivalent approach would be to treat the ALF as a standard leasing arrangement and calculate the break-even lease rate where the average efficient operator would be indifferent between buying the asset (i.e. an upfront payment) and leasing (i.e. paying annual fees). The break-even lease payments are determined by:</p> <p><i>PV of after tax lease payments + PV of amortisation tax benefits = purchase price of asset i.e. LSV</i></p> <p>4.36 In such a calculation, all discounting is done at the after-tax debt rate. If a rate higher than the debt rate were used it would similarly be an after-tax rate that would be used to discount the incremental after-tax cash flows arising from switching from a lump sum to ALF.⁷⁴ As can be seen from the two equations, the TAF and the standard lease approach both incorporate the same elements (PV of tax benefits of lease payments, PV of amortisation tax benefits, lump-sum value, discounting at the after-tax rate). Our current judgment is therefore that this would not give a different answer than that given by the current approach, but it would show how the TAF arises in a standard discounted cash flow analysis.</p>
Step 4 - Annual Licence Fees (ALF) for 900 MHz and 1800 MHz in UK (including implementation)	Adopting a common date for implementing revised ALFs	<p>6.10 We said in the October 2013 consultation that we recognised that changing the payment dates applying to the licences so that they are identical (i.e. having a common actual payment date) may be unnecessarily disruptive to licensees, recognising that arrangements for licence fee payments under these licences are of longstanding duration. However, since then we have considered further how we would implement our proposal to increase ALF each year in line with inflation (see further Section 4 of this document and paragraphs 6.22-6.25 below). We now consider that it would be better to move licensees to a common actual payment date as the way to ensure consistent treatment between the licensees. It would simplify the regulations and their implementation by comparison with the alternative of having to specify and implement different inflation adjustments across the year (to reflect different licensee payment dates). However, recognising that changing the fee payment date may cause some disruption to licensees, we don't think we should do this at the same time as we introduce revised ALF.</p> <p>6.11 We are therefore minded to have a common date for the introduction of revised ALF, and we think that it would be pragmatic, fair and reasonable to implement this common date by:</p> <p>a) setting a common effective date for the introduction of revised ALF with each licensee's payment date remaining as it currently stands for payment of the first ALF following this common effective date; and</p> <p>b) after the first payment of revised ALF, for subsequent ALF payments to be made on a common actual payment date (i.e. by changing each licensee's payment date so that they are all on the same date). We propose that the common actual payment date would be the first anniversary of the common effective date.</p>
	Whether to phase in revised	6.13 A number of respondents (including the MNOs and Prospect) argued in their responses to the

	ALFs	<p><i>October 2013 consultation that there was a case to phase in the new fee rates over time and that we should consider the impact of different lengths of phase-in on investment, notably the deployment of 4G networks. Some of the responses drew attention to other cases where increased fees have been phased in over time.</i></p> <p><i>6.14 We have considered these arguments carefully. We are conscious that a significant period of time has passed since the Government direction was made in December 2010, and since the conclusion of the UK 4G auction in March 2013. Taking that into account, in light of these responses we think that a fair and reasonable approach for us to take is to set a common effective date as soon as practicable after the new fees regulations come into force, with a two-stage phase-in of revised ALF.</i></p>
	The period over which to phase in ALFs	<p><i>6.14 ... This phase-in would consist of the following (abstracting from indexation for inflation for simplicity):</i></p> <ul style="list-style-type: none"> <i>• one half of the increase (from the current ALF rate to the proposed new ALF rate coming into effect on the CED; and</i> <i>• the second half of the increase becoming effective one year later (which as set out above would be the common actual payment date). From this date ALF rates would be at the proposed revised level.</i>