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By email

14 August 2017

Dear Robert

OFCOM's Consultation "Notice of OFCOM's proposal to make regulations in connection with the award of 2.3 GHz and 3.4 GHz spectrum", dated 11 July 2017

Telefónica UK Limited ("O2") is grateful for the opportunity to provide comments on OFCOM's July 2017 Notice of Ofcom's proposal to make regulations in connection with the award of 2.3 GHz and 3.4 GHz spectrum. O2 welcomes OFCOM's plan to schedule the start of bidding in late October.¹ It is essential that the award of spectrum is not delayed.

We have deliberately kept our comments brief. We set out at length our position on the appropriate competition measures in our response to the November 2016 consultation and in our letters of 4 April 2017 and 4 July 2017. We understand that OFCOM is now calling for comments on the means by which effect would be given to OFCOM's decision on the appropriate competition measures, rather than on the broader decision itself and the reasoning which underpins it. For the avoidance of doubt, we reserve our position in that regard.

Question 1: Do you have any comments on the changes we are proposing to the draft Regulations, as summarised in paragraph 2.5 and described in detail in this notice?

O2 is in favour of the implementation of all the changes to the draft Regulations, as proposed by OFCOM. We set out our comments on each of the four changes here.

¹ Based on the timetable set out at §1.45 in OFCOM, Statement on "Award of the 2.3 and 3.4 GHz spectrum bands – Competition issues and Auction Regulations", 11 July 2007 ("the Statement").



Overall spectrum cap of 340 MHz

At §8.80-8.97 of the Statement, OFCOM discusses the practical implementation of the 340 MHz cap within the auction rules. OFCOM proposes that the cap take into account any withdrawn bids, in addition to new bids and standing high bids, as these could still become winning bids. This introduces a so-called “*bid constraint effect*” which under very limited conditions may constrain the bid options of a bidder that submits a withdrawal. As OFCOM points out, the bid constraint can only affect one bidder (Vodafone); it is also “*unlikely to arise in practice*” (§8.92). We agree with OFCOM’s analysis that this issue is not a material concern and that measures to mitigate the effect would unnecessarily complicate the Auction.

We further note that while the inclusion of withdrawn bids in the cap precludes a bidder from winning more spectrum than is permitted under the cap, it does not preclude a bidder that makes a withdrawal from winning more spectrum than its initial eligibility. As with the bid constraint effect, such a situation is unlikely to arise in practice. Further, such an outcome is only possible if the bidder pays a premium for the withdrawn lots, so we see no obvious rationale for a bidder to pursue such a strategy. Accordingly, we do not consider this issue to be a concern.

Deposits during the principal stage

O2 supports the change to the regulation on deposits. In the context of this Auction, it is appropriate that OFCOM has discretion to increase the amount that a bidder is required to have on deposit up to the level of its highest bid in any previous principal stage round. Over the course of the Auction, a bidder’s financial exposure may rise and fall, depending on their activity and the relative price levels across the two bands. The change in regulations gives OFCOM appropriate flexibility to manage deposit levels so as to mitigate the risk that a bidder bids beyond its financial means.

The regulations are drafted on the basis that deposits are submitted in the form of cash. We request that OFCOM consider allowing bidders to submit bank guarantees in lieu of cash deposits. We believe such a measure would be in the interests of all parties, as it would provide greater financial flexibility for bidders and would offer the same financial security to OFCOM. Accordingly, our understanding is that any amendment to the regulations to incorporate bank guarantees would not be a material change, and thus could be introduced without any need for further consultation.

Name of pre-existing licence holder in 3.4 GHz band.

We have no comment on this change.

Process if pre-existing licence holder is excluded

We have no comment on this change.



Question 2: Do you have any other comments on the drafting of the proposed regulations?

In our response to the November 2016 consultation, O2 reiterated its support for OFCOM's proposed auction design (with the exception of the competition rules) and the draft Auction Regulations. Our view remains that the auction design is fit for purpose, and the award should proceed on this basis as soon as possible. Here, we set out our comments on issues raised by other parties and make some requests with respect to OFCOM's approach to setting of parameters during the Auction.

Comments from other stakeholders on the design

Vodafone, BT/EE and H3G all submitted questions regarding the detail of the design. OFCOM has considered each of these questions and, based on the reasoning set out in Chapter 8 of the Statement, decided not to make any changes to the regulations. We are satisfied with OFCOM's response and see no merit in further discussion of these issues.

At §8.57-8.79 of the Statement, OFCOM discusses a request from H3G for special treatment with respect to options for the assignment of its pre-existing licences in the 3.4 GHz band. This section is heavily redacted, so our ability to provide comment is limited. However, based on the text provided, we strongly agree with OFCOM's decision and its rationale for not altering the regulations. The current rules for the assignment stage provide a level playing field between all bidders and offer the greatest scope for an efficient assignment of the spectrum.

Parameters for the Auction, including bid increments and round scheduling

The Auction Regulations give OFCOM wide discretion as Auctioneer to set parameters for the Auction, in particular in relation to the scheduling of auction rounds and the application of price increments between rounds. Whilst we do not object in principle to such discretion we request that, both before and during the Auction, OFCOM provide timely guidance on its approach to setting key parameters, so as to assist bidders in managing their budget planning and governance processes.

We understand that OFCOM intends to "*provide an illustration of the indicators we will be looking at when setting price increments as part of the Guidance for Bidders which we will publish closer to the start of the auction.*"²

With respect to the "Guidance for Bidders", we have two specific requests:

1. Price increments. OFCOM should apply modest absolute price increments. This is particularly important as demand approaches supply in a category, for two reasons. Firstly, in each category, there could be a difference of one bid increment in the price per lot paid by each winning bidder. As each bidder must pay the same price

² OFCOM, Consultation on "Award of the 2.3 and 3.4 GHz spectrum bands - Competition issues and auction regulations", November 2016 §7.11.



per lot for all lots that it wins in the same category, there could be a material difference in payments between bidders winning multiple lots. If Ofcom retains large increments to the end, it risks encouraging bidders to game the close to try to avoid paying the higher price. Secondly, with larger increments, there is an increased risk that the price increment could “overshoot” the market clearing level, and this could affect the efficiency of the auction outcome at the margins.

OFCOM has previously stated that “*we do not expect to set large price increments from one round to the next*”³ and that it expects to set “*price increments of no less than 2% and no more than 20% from one round to the next.*”⁴ We interpret this preliminary guidance as meaning that OFCOM may use large percentage bid increments initially but will make regular reductions in the percentage as the Auction progresses, so as to ensure that absolute price increments do not become too large.

2. **Guidance.** We request that OFCOM provide as much advance guidance as possible with respect to the auction schedule (number of rounds per day) and maximum bid increments in pounds that may be applied. This will enable bidders to forecast their potential financial exposure, manage their governance process and forecast the impact of deposit calls. In particular, it would be helpful if, prior to each bidding day, OFCOM sets out a maximum number of rounds and a maximum limit of price increases for that day. Such guidance is particularly valuable in the latter stages of a competitive auction.

Given the rules of this Auction, as demand approaches supply, the frequency of rounds in which price increments are required may slow. In such situations, OFCOM may be tempted to speed up the bidding process. If it decided such action was appropriate, O2 requests that OFCOM consider having more frequent auction rounds, as opposed to raising the percentage bid increment.

Yours sincerely

Lawrence Wardle
Director of Regulatory Affairs

³ OFCOM, Consultation on “Public Sector Spectrum Release (PSSR), Award of the 2.3 GHz and 3.4 GHz bands”, November 2014, §6.37.

⁴ OFCOM Consultation, November 2014, §A6.62.