



Non-confidential version

Issue 1

BT's response to Ofcom's consultation on:

**Annual licence fees for
900MHz and 1800MHz spectrum**

Issued by Ofcom on 10 October 2013

Executive Summary

1. Ofcom's analysis of how to establish market value for the 900MHz and 1800MHz spectrum is comprehensive and the supporting reports by external consultants have analysed the issue from many angles. We acknowledge that there is no precise answer to this question that can be deduced from the data available and we understand that a degree of expert judgement is required to settle on market values for spectrum in these two bands.
2. Although we agree that Ofcom's market value proposals are in the right ball park, we consider that the effects of the subsidy to the price paid by H3G for their spectrum has distorted Ofcom's estimate of 800MHz market value. Also, the impact of the spectrum caps, which artificially constrained demand and will have therefore affected prices paid, has not been adequately considered in the analysis. These factors have led Ofcom to under estimate market values.
3. Ofcom considered (and rightly rejected) an argument that the reserve prices, that contributed to the calculated second prices, were too high. However, we suggest that the reserve prices only featured in the second price calculation as a consequence of the spectrum caps preventing demand for all available lots from being expressed. A cursory analysis of the primary round bid data reveals that winners of spectrum included bids for larger amounts of spectrum in early primary rounds at clock prices above the reserve prices and so it is reasonable to infer that reserve prices were below valuations and were in the event not too high.
4. BT considers that the UK auction result gave a clear indication of the lower bound of UK market value for 800MHz coverage obligated spectrum, in the form of the price paid by Telefonica for its 2x10MHz package. This was £550m plus a £60m coexistence fund payment, which equates to **£30.5m/MHz**. It is reasonable to assume that standard 800MHz spectrum without a coverage obligation would not have any lesser value. We therefore consider the proposed valuation of similar 900MHz spectrum at **£25m/MHz** to be an under estimate of its value, even before factoring in the effect of the spectrum caps.
5. We estimate the paired 2600MHz spectrum price paid in the UK auction to be £4.5m/MHz based on a simple linear fit of the auction results when the O2 and H3G single band packages are fixed at the actual prices paid. This we suggest represents the lower bound of market value and is very close to Ofcom's figure of £5m/MHz. The better coverage of 1800MHz spectrum can be accurately reflected by averaging 800MHz and 2600MHz values, suggesting a price of $0.5 \times (30.5 + 4.5) =$ **£17.5m/MHz** is appropriate. We therefore again consider Ofcom's proposal of **£15m/MHz** to under estimate market value.
6. We understand that Ofcom's lower figures for 800MHz and 2600 MHz spectrum values are mostly due to Ofcom's additional consideration of spectrum values in markets outside the UK. However, we suggest that the purpose of the Government's direction is to reflect market value of UK spectrum in the UK market, since that is where it is used. Prices in other markets will reflect the situation in those markets, including the degree of competition and other factors which are irrelevant to the UK market. It would be logical to aim at a level playing field of spectrum costs between UK operators that bought UK spectrum in UK auctions and those who hold historical spectrum assignments that were not charged for up front.
7. BT has no comments on the method used to convert lump sum values to an annuity and is content with the proposed phasing in arrangements of the new fees.

Introduction

BT is pleased to contribute its views on the proposed annual charges that will be applied to 900MHz and 1800MHz mobile spectrum. We recognise the history of why the Government has directed that these must reflect full market value and we understand the difficulty this presents to Ofcom in terms of how to decide appropriate annual charges. It is clear that a degree of expert judgement is required to arrive at suitable figures, weighing up all the available evidence but paying particular regard to the bids made in the UK 4G auction, as required by the Government's Direction.

We acknowledge that particular emphasis has to be placed on market values revealed by bids in the UK 4G auction, but we would highlight that the limitations and constraints of the UK auction need to be taken into account where these have affected the apparent UK market prices. As the relevant spectrum is used in the UK and not elsewhere, it is the UK market conditions and auction prices that are the most relevant ones to consider. International benchmarks are more relevant to relative values of spectrum across bands.

BT's interest in this subject is to ensure that a more level playing field is established between parties, such as BT, who face the market value price of spectrum acquired at auction and those that, for historical reasons, use spectrum that is currently priced on a different and much cheaper basis that does not reflect its true market value and scarcity. This asymmetry in costs can distort competition. Also if the 900/1800MHz spectrum were not charged to reflect full market value then its tradable value would be correspondingly higher, meaning that if it were sold then the present owner would make windfall profits, which would again be a competitive distortion.

[REDACTED]

Our answers to the consultation questions are provided below.

Our responses to the consultation questions

Question 1: Do you agree with the approach that we propose to deriving a lump sum estimate of full market value for licences for 900 MHz spectrum and for 1800 MHz spectrum?

The approach that Ofcom has taken appears to be based in essence on taking linear reference prices derived from the UK auction data by DotEcon and then adjusting these using expert judgement after studying auction results from other countries, scaled to UK population size, particularly those considered to be more relevant.

Whilst we agree that the lump sum values that Ofcom has derived are in the right ball-park, we consider that they under estimate full market value. One concern is that the effects of the UK auction caps, which constrained participants so that they could not express value for larger amounts of spectrum, especially 800MHz, have not been considered in any of the analysis. We consider that the caps prevented the value for larger packages from being expressed and this will have reduced the second prices. Also the discount in the price paid by H3G as a result of the auction rules that guaranteed they would win spectrum has been considered but not been taken into account in the final proposals. These factors suggest that the true full market value is higher than the values derived.

Ofcom considered (but rightly rejected) an argument that the levels of the reserve prices, that contributed to the calculated second prices, were too high. However, we suggest that the reserve prices

only featured in the second price calculation as a consequence of the spectrum caps preventing demand for all available lots from being expressed. A cursory analysis of the primary round bid data reveals that winners of spectrum included bids for larger amounts of spectrum in early primary rounds at clock prices above the reserve prices and so it is reasonable to infer that reserve prices were below valuations.

We note that Ofcom has taken into account auction results in other markets and as a consequence has proposed lump sum values that are below the linear reference prices derived from the UK auction data. We believe that the intent of the Directions to Ofcom are to set the UK spectrum fees based on UK market value of spectrum, not the market value of spectrum in other markets where the competitive dynamics may be different. We consider that auction prices in other markets may be relevant in assisting assessment of the ratio of spectrum value in one band compared to another, but less so in terms of absolute values.

We consider that the linear reference price calculation used may be more complicated than necessary and the inclusion of the H3G price paid may have distorted the results. The H3G price paid is artificially low because of their guaranteed minimum spectrum and the way H3G's price was calculated in the auction rules resulted in a substantial discount to them.

Question 2. Do you have any comments on our assessment of the lump sum value of (a) a licence for 900 MHz spectrum; or (b) a licence for 1800 MHz spectrum?

BT considers that the UK auction result gave a clear indication of the lower bound of UK market value for 800MHz coverage obligated spectrum in the form of the price paid by Telefonica for its 2x10MHz package. This was £550m plus a £60m coexistence fund payment, which equates to **£30.5m/MHz**. It is reasonable to assume that standard 800MHz spectrum without a coverage obligation would not have any lesser value. We therefore consider the proposed valuation of 900MHz spectrum at **£25m/MHz** to be an under estimate of its value, even before factoring in the effect of the spectrum caps.

We estimate the paired 2600MHz spectrum price paid in the UK auction to be £4.5m/MHz, based on a simple linear fit of the auction results with the O2 and H3G single band packages fixed at the prices actually paid. This we suggest represents the lower bound of UK market value and is very close to Ofcom's figure of £5m/MHz. The better coverage of 1800MHz spectrum can be accurately reflected by averaging 800MHz and 2600MHz values. This assertion can be justified based on the analysis in Table 16 of Ofcom's recent consultation on Mobile Data Strategy. This suggests a price of $0.5 \times (30.5 + 4.5) = \mathbf{£17.5m/MHz}$ is appropriate. We therefore consider Ofcom's proposal of **£15m/MHz** to under estimate market value.

[REDACTED]

Question 3. Do you agree with our approach to annualising the proposed lump sum value, including the cost of capital which we propose to use?

BT has no comments on the details of how the lump sum value is proposed to be annualised.

Question 4. Do you agree that fees should be specified in constant real terms and should be adjusted annually in the light of changes to the Retail Prices Index (RPI)?

Yes this approach is reasonable.

Question 5. Do you agree that revised fees should be implemented in a manner which has an effect such that all licensees are charged higher fees simultaneously, even though payment dates of individual licensees may vary?

Yes it is fair that all parties are charged the new fees simultaneously.

Question 6. Do you agree it is appropriate that revised fees should be payable in full as soon as practicable after revised fee regulations are made.

Yes this would be consistent with the requirements of the relevant Directions to Ofcom and would be fair given that other mobile market competitors have already paid full market value for their spectrum.

Question 7. Do you have any views about the minimum period that should elapse before we should consider revising fees again?

We do not hold firm views on this question but suggest that c. 12 years may be appropriate. We note that the 2100MHz spectrum licences will have annual charges applied from 2022 and so proposals for those would presumably be consulted on ahead of that date. We don't see any reason to review 900/1800MHz at the same time as 2100MHz and in the absence of further relevant auction data it is unclear on what basis another review of 900/1800MHz fees would be undertaken.