ANNUAL LICENCE FEES CONSULTATION

ANNEX 1

LEGAL ANALYSIS

1. Introduction and summary

1.1 Vodafone welcomes the opportunity to comment upon the legal framework relevant to the setting of spectrum charges, set out in Ofcom's consultation document 'Annual Licence Fees for 900MHz and 1800MHz spectrum'. The legal framework adopted is critical given that the proper application of that framework will ultimately determine whether Ofcom's approach to the setting of spectrum charges will operate in the interests of industry stakeholders and the mobile consumers they serve. That principle – which is uncontroversial – reflects the fact that such charges are not an end in themselves, but a way of achieving a given end.

1.2 Vodafone has already highlighted to Ofcom, in an opinion provided by leading counsel[1], many of the legal considerations that Ofcom must take into account when setting spectrum charges. However, there is no evidence that Ofcom has grappled with any of these considerations, so we provide in this submission an extensive analysis of the legal framework and its application to the setting of spectrum charges.

1.3 As things stand, Ofcom's current approach is insufficiently grounded in the legal and regulatory framework governing it; consequently, any decision to proceed on the basis of the consultation document:

1.3.1 is incompatible with Ofcom's statutory duties; and

1.3.2 as such is not robust and thus vitiable.

1.4 These flaws arise principally because:

1.4.1 Ofcom appears to have fundamentally misunderstood and misinterpreted the provisions of the Direction issued by HM Government in relation to the setting of spectrum charges:

(1) It directs Ofcom to 'reflect full market value' when revising the fees payable for 900 and 1800 MHz spectrum and 'have particular regard to the sums bid for licences in the Auction';

(2) It does not, however, absolve Ofcom of the obligation to assess all evidence critically and draw the correct conclusions from it; nor does it exclude Ofcom's other EU and UK law duties which must be achieved and taken into account when interpreting the Direction.

[1] We append this original opinion provided by Sir Francis Jacobs QC to our legal submission at Appendix 1.

1.4.2 Had it properly interpreted the Direction, Ofcom would have recognised and clearly stated that it is seeking to set fees no higher than is strictly necessary to achieve its stated objective. Instead, it has failed to articulate its objective when setting spectrum charges and rigidly and exclusively focused on one element of the Direction and mechanistically (mis)applied outputs from the UK and other auctions to derive a proposed set of spectrum charges without any consideration of the effect on industry and consumers;

1.4.3 Ofcom consequently has erred in law by failing to recognise and actually give effect to its duties mandated by the harmonised pan-European Common Regulatory Framework (the "CRF") when setting spectrum charges. No consideration has been given to the express purposes of the Direction, the application of the principle of proportionality, ensuring the optimal use of spectrum or Ofcom's duties in regard to promoting the interests of consumers.

1.4.4 In particular, Ofcom has failed to recognise the high standard of proof that it must seek to demonstrate when conducting a prospective analysis of the kind contemplated in a matter that has very significant ramifications for the future of the mobile industry and consequently mobile consumers;

1.4.5 Consequently, Ofcom has not undertaken any credible assessment of the impact of the proposed level of its proposed spectrum charges, resulting from its proposed approach, upon mobile operators and correspondingly mobile consumers (as it is required to do as a matter of law).

1.5 As such, Ofcom's oft-repeated assertion that the proposals are 'consistent' with its various statutory duties is simply without foundation.

1.6 More specifically and significantly:

1.6.1 The proposals for the increase in existing spectrum charges are not objectively justified except by a passing reference to the Direction, which must be appreciated in the wider statutory context when adopting any decision on ALF.

1.6.2 There is no evidence or analysis as to the context and purposes of the Direction that would inform the exercise of Ofcom's discretion and judgment. Critically, Ofcom does not analyse:

(1) the extent to which the proposals promote investment and create greater investment certainty for operators (objectives that are stipulated by the Communications Act and also the Direction);

(2) The extent to which the proposals lead to greater coverage (which is also a purpose of the Direction);

(3) How the terms 'have particular regard' and 'full market value' should be construed against the overarching objectives of the Direction and the EU Regulatory Framework when seeking to analyse the recent UK auction and set spectrum charges.

1.6.3 This is consistent with the failure by Ofcom to analyse the wider context within which it exercises its radio spectrum functions and the obligations that apply to it in managing radio spectrum. Merely describing at length the numerous germane legal duties and obligations is not, on any objective analysis, an adequate substitute for demonstrating how these duties have been considered, applied and ultimately discharged.

1.7 Ofcom has also failed to recognise the high standard to which it must adhere when seeking to determine of the level of fees on a prospective basis. As we discuss in section 3 of this paper, it is now a well- enshrined legal principle that the more material the issue (in terms of the consequences or impact flowing from a particular decision about that issue), the greater the level of rigour and analysis that must be undertaken by a responsible regulator engaged in a forward-looking analysis. There can be little doubt about the significance of this issue for the mobile industry given that Ofcom's proposal will, if adopted, impose a new industry-wide cost on stakeholders of £300 million. This consultation document regrettably does not give effect to that core principle in any meaningful sense.

1.8 Instead, Ofcom seeks refuge within the margin of discretion that it considers is afforded to it in such matters and relies upon a mantra of 'regulatory judgment' at every turn. That discretion is not unbounded for the very reason that both the EU and UK legislative scheme impose clear safeguards and constraints that stipulate how Ofcom must act when exercising its radio spectrum duties.

1.9 Indeed, had Ofcom recognised and applied the duties applicable standard of proof when undertaking its assessment, it would have recognised that it has failed to consider the following key issues when assessing complex questions of quantification involving regulatory judgement. Specifically:

1.9.1 Ofcom must undertake a credible impact assessment that complies with Ofcom's statutory duties and published guidelines, outlining a number of options including a 'do nothing' option (which in the context of the Direction, would include consideration of whether minimal or no change to existing levels of licence fee fully are capable of meeting the requirement of section 6 of the Direction and more apt to realise Ofcom's wider obligations).

1.9.2 That impact assessment is critical to determine whether or not the proposed new level of spectrum charges enables Ofcom to satisfy itself that it has attained its broader statutory duties mandated by the EU Regulatory Framework and must include:

(1) the impact of Ofcom's proposals for a significant increase in spectrum charges on industry stakeholders (notably in terms of the incentives to invest and innovate);

(2) the impact of Ofcom's proposed level of spectrum charges on mobile consumers (with reference to different consumer groups); and

(3) the risk of handback of spectrum by existing licensees were spectrum charges to be set too high, with consideration of the consequences for mobile consumers of any period in which spectrum may lie fallow following. To date, Ofcom's dismissal of that risk in its assessment of asymmetry of risk is little more than theoretical assertion with no attempt to obtain any evidential underpinning for its position.

1.9.3 consideration must be given to whether the proposals are necessary to promote competition (or whether promoting competition is appropriate in this context);

1.9.4 Any transparency as to what role is played by evidence in reaching Ofcom's proposed conclusion, and what role is played by regulatory judgement.

1.9.5 Ofcom must consider whether to adopt a transitional phasing in period to ameliorate the harmful impact of a significant increase in the current level of spectrum charges upon industry stakeholders and their subscribers. In this regard, Ofcom's current reasoning for its refusal to countenance any kind of phasing in period is negligible; and

1.9.6 the timeframe over which ALF should be set and how the level of fees set during that period achieves Ofcom's obligations to promote legal and regulatory certainty upon which industry stakeholders depend when taking investment decisions.

1.10 As set out in more detail elsewhere in Vodafone's submission, Ofcom's proposals about the level of any future spectrum charge also contain manifest errors of assessment resulting from:

(1) a flawed analysis of the recent 800MHz/2.6GHz auction. As is demonstrated by the analysis undertaken by Frontier Economics, if the UK auction is assessed correctly, it can provide a useful starting point for seeking to derive the market value of 900 and 1800MHz spectrum held by existing licensees, but to apply properly the concept of 'market value' which Ofcom correctly equates with the 'market clearing price when supply equals demand', it must turn its mind to the identity of the 'marginally excluded user' and its value for the marginal increment of spectrum which is something Ofcom singularly fails to do ;

(2) inappropriate use of international benchmark evidence characterised by a notable failure to place that evidence in its full market context and thus determine its relevance to the UK market;

(3) a failure to take proper account of other well-established and previously used methodologies (such as cost modelling) for the setting of spectrum charges that might permit calibration of the UK auction analysis and international auction benchmark data, with the most cursory of explanations for why such methodologies are not appropriate in this case;

(4) A failure to consider and take into account relevant facts and information, most notably about the differences between 800MHz and 900MHz spectrum and the potential release of new spectrum bands. These factors have a bearing upon the value of 900MHz spectrum and the level of discount from a properly determined 800MHz value which should be applied to determine any future spectrum charges. In this regard, Ofcom has failed to act in accordance with its own previously stated commitment to take into account such differences when setting spectrum charges for the 900MHz band.

1.11 In the absence of evidence to the contrary, Vodafone is left with little alternative but to draw an inference that Ofcom's unorthodox and flawed procedural and substantive framework flow from a misconceived attempt to frame its decision in a way that would survive a challenge by way of judicial review. As well as being wholly inconsistent with Ofcom's general duty of transparency, it is also seems to be based on a misunderstanding of the intensity of review implied by the operation of Article 4 of the Framework Directive in any judicial review. In any event, the errors of law, procedure and assessment that emerge from this legal analysis are sufficiently glaring that any decision to proceed upon the basis of the consultation document would be very unlikely to withstand an action for judicial review.

1.12 Given the materiality and multiplicity of these legal errors, Ofcom must:

1.12.1 Withdraw its current proposals;

1.12.2 Re-consider the matter *ab initio*, with the starting point being to develop a range of proposals which have as their primary purpose furthering the interests of consumers, creating greater investment certainty, maximising coverage and ensuring optimal use of spectrum;

1.12.3 Undertake a fresh analysis of the auction data to derive a figure that is much likely to provide a reliable starting point for assessing the value of 900MHz spectrum, with an appropriate discount reflecting the differences between 900MHz and 800MHz spectrum in the UK;

1.12.4 Undertake technical cost modelling as a way of validating the values for the 900MHz band derived from any auction analysis;

1.12.5 Undertake a proper impact assessment, balancing a range of proposed options for spectrum charges to determine that Ofcom's preferred course of action will realise its statutory objectives and duties;

1.12.6 Explain clearly why it believes that the net effect of these proposals furthers the interests of consumers, mindful of the fact that:

(1) Any direct impact on consumers is likely to be harmful (higher prices and/or lower investment in network coverage);

(2) Other justifications for spectrum fees higher than Ofcom's costs need to be fully grounded in Ofcom's statutory duties under section 3 WTA06 (which does not include the 'full suite' of duties under sections 3 and 4 CA03);

1.12.7 Issue a new consultation (reflecting the fact that industry stakeholders would not have had the opportunity to consider Ofcom's revised analysis) on a range of possible outcomes, providing much greater transparency on the exercise of regulatory judgement through a well-reasoned, evidential approach;

1.13 Until and unless Ofcom corrects its approach to the setting of fees and runs a proper impact assessment, it is clear that Ofcom is setting those fees in a regulatory and policy vacuum. It is accordingly difficult to see how Ofcom can be satisfied that it is acting in accordance with its obligations when setting these fees.

1.14 This submission is set out in six sections:

1.14.1 This executive summary (section 1);

1.14.2 Section 2 briefly summarizes the errors of fact and problems with Ofcom's economic reasoning identified by Frontier Economics (focusing specifically on those errors of fact that are relevant to the legal analysis in this submission);

1.14.3 Section 3 deals with Ofcom's overall approach as it is set out in the consultation document and explains why it is misconceived in material respects;

1.14.4 Section 4 deals with specific errors of law made in relation to Ofcom's analysis in relation to section 6 of the Direction;

1.14.5 Section 5 attempts to repair some of the gaps in Ofcom's legal analysis, by properly characterising Ofcom's relevant statutory duties and their significance to the revising of the ALF, and by working

through the sequence of reasoning that Ofcom is duty-bound to undertake in relation to any proposed amendment to the licence fee; and

1.14.6 Section 6 sets out some of the other steps Ofcom should take in developing any revised proposals, including setting out a range of options and drawing on a wider and more robust pool of evidence, including cost modelling.

2. Manifest errors of fact resulting from a flawed assessment of the auction data

2.1 This section 2 briefly considers the material errors of fact and problems with Ofcom's economic reasoning identified by Frontier Economics that give rise to obvious concerns from a legal perspective.

2.2 In the consultation, Ofcom understands its task is, pursuant to the Direction, to determine the 'market value' of 900MHz and 1800MHz spectrum and does so by reference to an 'evidence base'. The evidence base that Ofcom considers appropriate and relevant to determining market is:

2.2.1 UK 4G auction prices; and

2.2.2 international benchmark evidence.

2.3 We examine in greater detail at sections 3, 4, and 5 the role, status and interpretation of the Direction when considering how Ofcom should set spectrum charges. The Direction itself is neither complex nor controversial. Nevertheless, Vodafone considers that Ofcom has failed to interpret and apply the Direction in a way that seeks to attain its duties. That critique is set out in sections 3 and 4 (and an approach that would be more closely aligned to Ofcom's relevant duties is set out in section 5, whilst some steps that Ofcom could take to address some of the flaws in Ofcom's proposals are set out in section 6). This section 2 deals with the problems that arise from Ofcom's flawed application of the provisions of the Direction in relation to the assessment of potentially relevant evidence.

2.4 In essence, these provisions require that Ofcom must revise the level of fees in a way that *reflects* full market value. In performing that task, Ofcom is invited by the Direction to consider the relevance of the bids made in the recent 800MHz and 2.6GHz auction. Using such auction data as the starting point for seeking to determine the 900MHz band is reasonable, provided that Ofcom is able to take into account and adjust for the limitations inherent in that dataset. If these limitations are properly considered and recognised, the auction data *could* indeed provide a useful input to any assessment of the value of 900MHz spectrum held by existing licensees.

2.5 There is no doubt why the Direction does no more than propose that Ofcom 'have particular regard to' the recent auction when seeking to assess full market value of the spectrum. The terminology employed in the Direction is a matter for detailed consideration in sections 4 and 5 of this submission, but suffice it to say that the nuanced and carefully drafted nature of the provisions of the Direction would enable Ofcom to decline to take into account the auction evidence if Ofcom ultimately were to conclude that data from the auction were subject to a high margin of error and should thus be disregarded when seeking to ascertain market value. Equally, the provisions of the Direction do not (and could not as a matter of law) prevent Ofcom from seeking to gather and take into account other and more recent evidence that would affect the utility of any auction data and the extent to which it should be relied upon in any assessment.

2.6 Indeed, in this regard, Ofcom's own proposal that it consider international benchmarks and technical evidence in the spectrum auction consultations of 2011/2012 is an explicit recognition that Ofcom is not limited to a mechanistic extraction of bid values from the auction. It must establish, through careful analysis of the bidding data which is most informative about the value of spectrum that has not been subject to any auction process. However, as we explain below, Ofcom has not undertaken a rigorous analysis that reflects or adjusts for the limitations inherent in such bid data. Nor has it sought to validate any data or conclusions drawn from the auction data by reference to alternative methods of assessing market value of spectrum (technical cost modelling); until it does revise its analysis in the way that Vodafone proposes, any spectrum charges that it proposes to set will be based upon erroneous analysis values that render those charges not fit for purpose.

2.7 Frontier Economics and Vodafone have undertaken detailed analysis to assess how robustly Ofcom has undertaken the assessment of the UK and other auctions. That analysis reveals significant errors of assessment, most notably:

2.7.1 Ofcom has simply failed to appreciate that the auction design - particularly those elements relating to spectrum cap applicable to certain operators and reserve prices - means the bid values generated in the auction process will be subject to a high level of uncertainty for the purposes of ascertaining of market value of 900MHz spectrum;

2.7.2 Ofcom thus fails to recognise that the most credible indicator of market value of 900MHz spectrum to be derived from the auction is the bid data of Everything Everywhere as the most likely marginal excluded user of the relevant spectrum;

2.7.3 To the extent that Ofcom seeks to rely upon data from auctions in other jurisdictions as a means of validating any UK auction data, there are dangers, as the Competition Appeal Tribunal has recognised, in selectively choosing facts about these auctions and then seeking to apply them to the UK:

"…it is difficult to draw any firm conclusions derived from disparate facts plucked out of the information about a range of international markets."[2]

As Ofcom is fully aware, mobile markets are national in scope, with each national market exhibiting very different competitive market structures and demand conditions. This is why allocation and ongoing management of a scarce resource relevant to the operation of these markets continues to be managed at a national level. In other words, Ofcom must seek to understand auction outcomes in the context of these markets to be able to drawn reliable inferences from these auctions. The paucity of Ofcom's analysis of these overseas markets and how specific market conditions might affect the utility of auction data in these markets is stark.

[2] Vodafone v Ofcom [2008] CAT 22, paragraph 127

2.8 Moreover, Ofcom has failed to seek to grapple with and take into account significant relevant considerations and information in any assessment of the relationship between the value of 800MHz and 900MHz spectrum. Ofcom appears to recognise that 900MHz cannot be considered a like-for-like substitute for 800MHz spectrum, but beyond that statement, appears to give little in the way of consideration of the factors that would affect the discount to be applied to any value of 800MHz spectrum derived from an analysis of the auction.

2.9 In this respect, any attempt by Ofcom to rely solely upon data generated at a fixed point in time would mean that it had unlawfully deprived itself of the opportunity to consider relevant information. As noted earlier, the Direction cannot, as a matter of administrative law, prevent Ofcom from seeking to examine other relevant evidence since the auction is only one potential source when determining the market value of 900MHz spectrum. Any approach to the contrary would mean that the Direction had caused Ofcom's approach to become ossified and incapable of adapting to changing circumstances. This is particularly relevant when considering that many of these overseas auctions occurred some time ago and bidding behaviour could not have reflected some of these changes in circumstances. The most glaring deficiencies are:

2.9.1 A failure to recognise and take into account new facts that have emerged only very recently. The most significant of these is the impending release of new very large blocks of spectrum available to mobile operators that clearly has a bearing upon the value of 900MHz spectrum. A number of the international auctions occurred well before any roadmaps for the release of spectrum would have been contemplated at pan-European or national level and therefore was not known (to anything like the current degree of certainty) to participants in these auctions. To the extent that Ofcom seeks to use bidding data from these auctions, it must amend its analysis of the value of 900MHz spectrum to take account of this fact. Given that Ofcom itself was fully aware of this development, having only very recently published its proposed approach to the release of additional spectrum bands in the coming years, it is surprising that there is no mention of these developments;

2.9.2 Ofcom does not appear to appreciate that the auction has yielded an outcome in which all 4 mobile operators now hold spectrum in the 800MHz band. This spectrum enables the operation of a national LTE network, which would make other spectrum bands a supplementary resource (rather than being a substitute) enhancing the quality of *existing* coverage (as opposed to further) coverage or providing additional capacity;

2.9.3 Accordingly, Ofcom fails to consider the distinction between spectrum used for capacity and spectrum used for coverage, and therefore does not consider the extent to which 800MHz spectrum may have value and utility that it is not possible to realise using 900MHz spectrum, affecting their relative values. Nor in this context, does Ofcom consider how the release of

new spectrum bands may reduce the utility of 900MHz spectrum as a complement to the 800MHz band even further;

2.9.4 A notable failure to properly use the available cost modelling to help address that issue (and other issues), where an appropriately scoped and executed cost model would equip Ofcom to make more effective judgements as to its view of various matters of fact in its chain of reasoning. This is a matter to which we return in section 6.

2.10 One consequence of these failures is that Ofcom does not seem to have turned its mind to the question of how to weigh up the relationship between evidence as to the historic price of 800MHz spectrum (which it is clearly required to have 'particular regard to' but which cannot by itself be determinative) and the question it is required to address, which is the forward-looking value of 900MHz spectrum.

2.11 All of the above material clearly has relevance to the value of 900MHz spectrum, yet Ofcom has failed to demonstrate in any way how these newly emerging facts may influence the value of 900MHz spectrum even though it has been in possession of these facts as it has deliberated over its approach to spectrum charges. As well as its failure to assess these issues and correctly identify them in its thinking (a significant procedural and substantive error), the failure to consider such facts also raise serious and much broader questions of law about the weighting that Ofcom has attached to particular evidence. Specifically, it is very doubtful that Ofcom can be confident that it has correctly applied its duties in attaching significant weight to the UK auction data and certain internal benchmarks in setting spectrum charges when there is a plethora of evidence at its disposal that is highly relevant to establishing full market value (discussed further in the following sections).

3. Ofcom's approach, the role of regulatory 'judgement' and the intensity of review

3.1 This Section 3 deals with the legal framework that Ofcom adopts when undertaking its analysis and explains why it is misconceived in material respects.

3.2 The Direction 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.*

3.3 Ofcom proceeds on the basis that the setting of spectrum charges requires that Ofcom sets the ALF based on a value that is exactly equal to the price that the licensed spectrum would fetch, if it were sold at auction.[3] Accordingly, in Ofcom's reasoning, the only relevant questions are:

3.3.1 What is the market clearing auction price? and

3.3.2 What are the correct steps to turn that price into an annual licence fee for spectrum in the neighbouring band?

3.4 Ofcom then proceeds on the basis that this exercise is a matter of regulatory judgment, in particular as to how the data from the auction should be analysed and then translated into a value for the 900MHz band. However, in exercising that judgment, Ofcom is not undertaking a simple, technical calculation – it is building a complex set of hypotheses, which (as it frequently acknowledges in the consultation) that engages a number of Ofcom's duties and requires an assessment from a number of different perspectives in order to attain those duties.

3.5 The fact that the task involves a degree of judgment has an important implication that Ofcom does not appear to appreciate. To ensure an appropriate level of regulatory certainty, and avoid the harm arising from regulatory risk, Ofcom is subject to a number of important constraints in the exercise of its discretion:

[3] More precisely, we mean that Ofcom is focused exclusively on the question of what is a 'market-clearing price' for each package of spectrum – that is, the price at which only one (winning) bidder remains for each package of spectrum, which is the price at which all other potential users of that spectrum withdraw. This definition and its implications are discussed in more detail in the Frontier Economics analysis of the UK auction

3.5.1 It is limited as to the *purposes* for which it can act in certain circumstances – in this case those contemplated by the EU Regulatory Framework and the Direction;

3.5.2 It is required to act consistently with its statutory duties;

3.5.3 It is subject to constraints as to what it must (and in some cases must not) take into account in reaching a decision; and

3.5.4 It is required to act consistently with certain restrictions as to procedure – for example, the requirement to act transparently, provide compelling reasoning for its proposed approach and subject its proposed approach to a credible impact assessment.

3.6 Ofcom's consultation document reveals that Ofcom has not properly taken into account these obligations or constraints upon its conduct. Instead of demonstrating convincingly that it the way in which it chooses to use the auction data will satisfy the wider purposes of the Direction and the EU Regulatory Framework, it prefers simply to engage in a series of mathematical calculations to derive a value for the 900MHz and 1800MHz band.

3.7 Ofcom's approach to its proposals in setting spectrum charges contrasts unfavourably with the approach that it pursues in similar significant ex ante regulatory decisions. These matters involve precisely the type of forward-looking assessments of the impact of the adoption of a particular regulatory option and questions of complex financial analysis informed by regulatory judgement that are also required in setting spectrum charges.

3.8 A good illustration of such a prospective analysis can be found in the approach to determining appropriate price controls. In such a case Ofcom is required to review markets, determine whether any operator or operator has significant market power and construct appropriate remedies. Ofcom analyses the state of competition as it affects consumers in relevant product and geographic markets, based on evidence gathered from market participants, including how competition may change over the review period when seeking to determine the form and extent of any regulatory intervention. This analysis is generally grounded in an analysis of Ofcom's relevant statutory duties, as well as other material of which Ofcom is required to have regard or to take utmost account.[4] Thus, whilst the subject matter that Ofcom may examine may be complex, it must still be capable of justifying, with transparent and credible reasoning, the basis for its proposed form of regulatory intervention.

3.9 There is no evidence of this type of analysis in relation to the ALF proposal. Instead, Ofcom appear to refer periodically to the Competition Assessments prepared for the auction. These assessments are cited, and it is stated that these have informed substantive views on any revision of the ALF, but it is not clear

[4] This is obviously a simplification, but, for these purposes, a reasonable one – Ofcom is well aware of the process and we have omitted a more detailed characterisation of the market review process for brevity.

how or where in Ofcom's analysis that has occurred. It is therefore difficult to understand how Ofcom can make a reasonable judgment, consistent with the its duties, about the impact that any proposed licence fee will have on the interests of consumers or competition in relevant markets.

3.10 In a market review, where there is a delay from the point where Ofcom completes its market power assessment to the point where it imposes a remedy, Ofcom undertakes analysis to update its findings in the market review. This is required as a matter of statutory practice in the access regime.[5] Although there is no corresponding requirement on Ofcom under the spectrum regime to perform this type of 'material change' assessment, the lack of a statutory requirement does not derogate from the fact that it is best practice and consistent with Ofcom's other duties to act reasonably and consistently to do so anyway. Self-evidently, the risk of regulatory error is higher if Ofcom opts not to do so.

3.11 This is not simply a 'technical' point; Ofcom's proposals are potentially a significant intervention affecting the competitive dynamics of the market and the overall degree of technological and commercial uncertainty in the sector is very high, particularly when viewed against the investment timetables necessary to deploy networks to use licensed spectrum. The gap from the most recent Competition Assessment to the date of this submission was a full 18 months; by the time Ofcom is in a position to complete this consultation and take a decision, it is plausible that it will be closer to 2 years since that analysis was completed. This is not a trivial period, and Ofcom cannot simply assert that market conditions have not evolved in that time without undertaking a rigorous investigation.

3.12 It would be relatively easy for Ofcom to consider these issues, for example, by taking a properly reasoned view as to whether the analyses undertaken ahead of the auction remain of sufficient probative value to remain current (that is, a view on whether there has been any material change) – and testing that view in the appropriate way in a public consultation. Without engaging with this question (most importantly how has the market changed in the last 2 years), Ofcom fails to equip itself with important information about changes in market conditions or other new developments that must inform the exercise of regulatory judgement relating to a prospective analysis in a matter of very considerable significance.

3.13 Given the centrality of spectrum, as a scarce resource and critical input to the provision of mobile communications services to mobile consumers, Ofcom must still undertake very similar tasks in relation to assessing competition and consumer impacts of setting spectrum charges to that involved in a price control. In establishing the proposed ALF, Ofcom's approach has been to largely ignore this approach in its assessment of the appropriate level of spectrum charges. We question whether that is sustainable (given Ofcom's duty to act reasonably and consistently), or that it is a good idea not to equip itself with the best analysis it reasonably can (in light of Ofcom's principal duty). We consider Ofcom's compliance with its statutory duties in section 5.

[5] Communications Act 2003, section 86.

3.14 It is not clear on the face of the consultation document why Ofcom's approach to setting spectrum charges departs so dramatically from that adopted relation to other parts of its sector sphere of responsibility. The answer appears to be that Ofcom considers that it is subject to a very different appeal regime that implies a much lower level of judicial scrutiny to the extent that it is absolved of the responsibility to undertake the rigorous analysis that is required to justify its proposals. We explain below and in section 5 why this thesis is simply not tenable.

Intensity of review

3.15 Although there is no direct reference to the possibility of Ofcom's decision being appealed in the consultation, Ofcom seem to place undue weight on what appears to be their reading of the provisions of the CA03 that exclude a decision to issue regulations under section 12 of the Wireless Telegraphy Act 2006 ("WTA06") from the scope of section 192 of the Communications Act 2003 ("CA03").

3.16 Several times in the text, Ofcom are at pains to emphasise the role played by "regulatory judgment" in its proposed approach to setting spectrum charges:

> *In order to determine fees we need to identify, for each of 900 MHz and 1800 MHz, a single figure for the lump-sum value of spectrum. We have a limited set of evidence points with a relatively wide distribution of values, and we consider that no specific evidence points can be relied on in a determinative way. Because of this we have not sought to take a mechanistic approach to deriving best estimates from the available evidence. Rather, we have considered the evidence for each band in the round, and used our judgement to decide how much weight to place on the various pieces of evidence to develop a best estimate for each band. (1.10)*
>
> *We recognise that there is uncertainty about the full market value of these bands and that the process of revising annual licence fees necessarily requires us to use our judgement to estimate the full market value. We have set out in this document our proposed approach for making this estimate, including proposing a figure for each band as our best estimate of full market value, given the available evidence. (2.10)*
>
> *As discussed above, deriving lump-sum values has been a matter of judgement in light of the available evidence. In deriving these values, we have considered all of the significant evidence, but we have placed materially more weight on what we consider to be more important evidence. (4.55)*
>
> *We are required by the Direction to revise ALFs to reflect full market value. In meeting that requirement we have exercised our regulatory expertise and judgement as to the weight that we should attach to the various evidence that is available to us and we have reached a view on our best estimate for each band of full market value (as a lump sum). We propose to use these best*

estimates for the purposes of deriving ALF. We consider that implementing the requirement in the Direction in this way is consistent with our statutory duties. (4.59)

3.17 By repeatedly asserting that any decision is based on upon so-called 'expert judgment', we assume that Ofcom is seeking to establish that this whole issue should not be subject to judicial scrutiny. This would appear to be an example of what has been characterised in other contexts as a regulator seeking to 'JR-proof' a decision.[6]

3.18 This is plainly inconsistent with Ofcom's relevant duty to operate transparently, provide clear reasoning and thus to ensure that any proposed course of action is objectively justifiable. However, this approach also appears to be based on a misunderstanding of the likely standard of review in any appeal of a decision to set regulations under section 12 WTA06. It is therefore important that there is no misunderstanding what the standard of review is in relation to decisions from Ofcom in relation to its powers under the WTA for spectrum management.

3.19 It is settled law that any appeal against a decisions to set regulations under section 12 WTA06 is to the Administrative Court by means of judicial review rather than an appeal under section 192 CA03. However judicial review in such circumstances would proceed by careful reference to the statutory context and, in particular, to the need to interpret UK law consistent with the terms of the relevant European legislation. The leading case on this point emphasises the common elements of the review undertaken under section 192CA03 and under JR in the context of Article 4 of the Framework Directive of the CRF:

Accordingly I think there can be no doubt that just as JR was adapted because the Human Rights Act so required, so it can and must be adapted to comply with EU law and in particular Art. 4 of the Directive. ***If the CAT did not exist JR would have to and could do the job.*** *The CAT's existence does not mean that JR is incapable of doing it.*

I would add this: it seems to me to be evident that whether the "appeal" went to the CAT or by way of JR, ***the same standard for success would have to be shown****. In either case it would not be enough to invite the tribunal to consider the matter afresh – as though the Award had never been made…*

[…]

After all it is inconceivable that Art. 4, in requiring an appeal which can duly take into account the merits, requires Member States to have in effect a fully equipped duplicate regulatory body waiting in the wings just for appeals. What is called for is an appeal body and no more, a body which can look into whether the regulator had got something material wrong. That may be very difficult if all that is impugned is an overall value judgment based upon

[6] BIS consultation, *Streamlining Regulatory and Competition Appeals,* 19 June 2013 paragraph 3.17.

competing commercial considerations in the context of a public policy decision.

[….]

…the common law in the area of [judicial review] is adaptable so that the rules as to [judicial review] jurisdiction are flexible enough to accommodate whatever standard is required by Article. 4[7]

…the JR standard of review can and does mould itself to any requirement imposed by other rules of law. [para 20]

…For the EU route she relied on Unibet v Justitiekanslern, Case C-432/05 [2007] ECR I-2271 where the ECJ said:

> *[44] Moreover, it is for the national courts to interpret the procedural rules governing actions brought before them, such as the requirement for there to be specific legal relationship between the applicant and the State, in such a way as to enable those rules, wherever possible, to be implemented in such a manner as to contribute to the attainment of the objective, referred to at paragraph 37 above, of ensuring effective judicial protection of an individual's rights under Community law.*

She said, correctly in my opinion, that this demonstrated an obligation on a national court to adapt its procedures as far as possible to ensure Community rights are protected. In setting the limits of what can be taken into account it follows that the JR court would itself conform to the requirements of Art. 4.

30. I would add this: it seems to me to be evident that whether the "appeal" went to the CAT or by way of JR, the same standard for success would have to be shown. In either case it would not be enough to invite the tribunal to consider the matter afresh – as though the Award had never been made.

3.20 'The job' is, in this context, providing an appeals mechanism that meets the standards of Art 4 FD (which in the UK has been transposed by means of section 192). Section 192 provides that in any appeal, the appeal must be determined '*on the merits*'; this transposes the requirement in Article of the Framework Directive that the appeals mechanism be one in which '*the merits of the case are duly taken into account*'.

3.21 It follows logically from that view that Ofcom may consider that in the case of a decision issued under the Wireless Telegraphy Act it faces a different, presumptively lower, degree of scrutiny arising as a result of facing 'merely' judicial review rather than appeal 'on the merits' that would be brought under section 192 CA03.

[7] *T-Mobile (UK) Ltd & Telefonica 02 UK Ltd v Ofcom* 2008 EWCA Civ 1373

3.22 In the first instance, Vodafone's legal analysis demonstrates that Ofcom's errors of law, procedure and assessment are so fundamental that a decision to proceed on the basis of the current consultation proposal would be set aside upon judicial review. However, there is another error of law on the part of Ofcom in relation to the appropriate standard of review and standard of proof upon Ofcom in the case of decisions taken pursuant to Ofcom's spectrum management powers.

3.23 Without re-hashing issues that are the subject of a separate consultation by Government[8], Vodafone believes that this view is inconsistent with the Court of Appeal's position. Taking into account the appeal mechanism that exists today under section 192, and after considering the position in relation to JR as adapted in light of Art 4 FD, Jacobs LJ could not be clearer in his finding: 'the same standard of success' applies in each case.

3.24 Ofcom has recognised, rightly, that any decision affecting the level of spectrum charges to justify undertaking an impact assessment that should underpin any proposed decision. The jurisprudence of the Competition Appeal Tribunal makes clear that what any decision in relation to ALFs (and the impact assessment upon which it is buttressed) must be capable of withstanding 'profound and rigorous scrutiny':

> *… the way in which the Tribunal exercises its jurisdiction is likely to be affected by the particular circumstances under consideration. What the above judgments clearly demonstrate is that the Tribunal may, depending on particular circumstances, be slower to overturn certain decisions where, as here, there may be a number of different approaches which OFCOM could reasonably adopt. There may be a variety of entirely legitimate reasons why the amendment of the current system of number portability in the UK is a desirable aim in pursuance of OFCOM's statutory duties (for example, conflicts of interest between different operators may prevent united action without regulatory intervention). Vodafone accepted that there were a number of approaches open to OFCOM in arriving at the Decision. However it is still incumbent on OFCOM, in light of their obligations under section 3 of the CA 2003, to conduct their assessment with appropriate care, attention and accuracy so that their results are soundly based and can withstand the profound and rigorous scrutiny that the Tribunal will apply on an appeal on the merits under section 192 of the CA 2003… It is the duty of a responsible regulator to ensure that the important decisions it takes, with potentially wide ranging impact on industry, should be sufficiently convincing to withstand industry, public and judicial scrutiny."* [9]
> [emphasis added]

3.25 Although the above-cited *MNP* case involved an appeal under section 192 CA03, a number of points arising from that case are particularly instructive:

3.25.1 The need to deal with each case on its own facts and to undertake any review in light of those facts and Ofcom's duties;

[8] BIS consultation, *Streamlining Regulatory and Competition Appeals,* 19 June 2013
[9] *Vodafone v Ofcom* [2008] CAT 22 (MNP), paragraph 46

3.25.2 In that case, the Tribunal overturned Ofcom's decision notwithstanding that Ofcom faces many of the same circumstances that it pleads as being relevant to the ALF consultation (such as conflicting interests of different commercial stakeholders and the exercise of regulatory judgment as to, for example, the choice between different options for reform); and

3.25.3 The centrality of Ofcom's duties under section 3, and the fact in particular that the final sentence identifies Ofcom's obligation to produce an analysis with 'appropriate care, attention and accuracy so as their results are soundly-based and can withstand … profound and rigorous scrutiny' as being grounded 'in light of their obligations under section 3 of the [CA03]'. Although in that case, the review fell under section 192 CA03, in light of the decision of the Court of Appeal cited above, Vodafone submits that where Ofcom's principal duty under section 3 is engaged in relation to the conduct of an impact assessment, Ofcom should perform its duties to the same rigorous standard and not seek to claim that it should not be held accountable for failure to meet that standard by virtue of the fact that the appeal proceeds by way of judicial review, suitably adapted in light of Article 4 FD and not by way of a review under section 192 CA03.

3.26 The aforementioned case law provides valuable guidance as to the level of rigour that must be demonstrated in the conduct of an impact assessment relating to a matter that has very material implications for the future of the mobile market and mobile consumers. That guidance is further reinforced by jurisprudence indicating the duty of care incumbent upon a responsible regulator that is engaged a prospective analysis. As noted earlier in this response, the decision that Ofcom will take in this case is prospective and has very significant potential implications for the development of the mobile market and the welfare of mobile consumers. This is most particularly apparent in relation to consideration of:

3.26.1 Diminished incentives to invest, in particular in the expansion of mobile infrastructure, on the part of licensees resulting from a significant increase in the level of spectrum charge ;

3.26.2 The extent to which a failure to provide for a suitable phasing in period for the introduction of any new spectrum charges will serve to exacerbate any adverse impact on investment incentives to invest;

3.26.3 The extent to which Ofcom's proposal fails to promote legal and regulatory certainty that is a prerequisite for sustained investment by mobile operators;

3.26.4 In the context of considering legal and regulatory certainty, the extent to which Ofcom's proposed increase in the level of existing spectrum charges creates a significant risk of handback of spectrum by licensees to the obvious detriment of mobile consumers.

3.27 In this regard, what Ofcom is undertaking in this consultation is akin to the type of forward looking analysis contemplated in a merger review by a competition authority. Whilst the competition authority must articulate a theory of harm resulting from a potential transaction, it must provide compelling reasons to explain why it considers that the prospect of any harm being realised is likely. In simple terms it cannot seek to fall back upon the principle of regulatory judgment or discretion to provide 'air cover' for a decision to approve or prohibit a decision. Instead, it must have investigated the matter thoroughly and in a way that is capable of providing clear and credible reasons for any ultimate decision:

"[B]ecause the likelihood of error is greater in a prospective analysis, the prospective analysis must be proportionately more rigorous to account for this possibility".[10]

3.28 That legal proposition has also been described in other cases as the double proportionality obligation that is relevant to any regulator assessing a matter with significant consequences for industry stakeholders:

""the more important a particular factor seems likely to be in the overall proportionality assessment, or the more intrusive, uncertain in its effect, or wide-reaching a proposed remedy is likely to prove, the more detailed or deeper the investigation of the factor in question may need to be…"[11]

"…within a wide margin of appreciation, the depth and sophistication of analysis called for in relation to any particular relevant aspect of the inquiry needs to be tailored to the importance or gravity of the issue within the general context of the Commission's task."[12]

3.29 Applying these European and domestic authorities to the case at hand, there can be little doubt that Ofcom is undertaking its regulatory function in a purely prospective sense. That in itself creates a clear obligation upon Ofcom to act rigorously and improve upon the desultory investigation of impacts and risk of consumer harm that it has undertaken to date. However, that obligation is all the more compelling in a case where there can be little doubt about the significance or gravity of the subject matter for the future development of the mobile industry. In section 5, we consider the extent to which Ofcom has been able to satisfy the obligations in relation to a number of issues germane to the setting of spectrum charges. Regrettably, we demonstrate in that section that Ofcom's current analysis would be deemed incapable of being compatible with these obligations. This is in large part because it has not taken into account and met the high standard to which it must adhere in a case of this kind.

[10] This language comes from a decision of the Irish Electronic Communications Appeals Panel referring to a decision of the European Court of First Instance, cited with approval by the CAT in Hutchison 3G (UK) Limited v Ofcom [2005] CAT 39 at 33.
[11] *Tesco v Competition Commission* (2009), CAT 6 paragraph 139
[12] *PPI* (2009) CAT 27, paragraph 21

4. Continuing error in law regarding the status and interpretation of the Direction

4.1 Ofcom's erroneous assumption about the standard of proof that is applicable when setting spectrum fees stems from its ongoing error of law in relation to the Direction, which it appears to believe provides with it with the freedom to set charges without the need to undertake a rigorous and robust analysis showing how precisely how its statutory duties have been attained. Section 4 of this submission addresses specific errors of law made in relation to Ofcom's analysis in relation to section 6 of the Direction and demonstrates why Ofcom must reconsider its legal analysis and the implications of its current interpretation for its current approach to the setting of future spectrum charges.

4.2 The Direction is an additional source of guidance for Ofcom as it seeks to derive a value for the 900MHz and 1800MHz spectrum bands that will determine the level of any future spectrum fees. Its operative provisions are relatively uncontroversial; they propose that Ofcom: (i) revise the level of 900MHz and 1800MHz charges in a way that reflects the full market value of those spectrum bands; (ii) consider the bids in the recent 800MHz spectrum as an input for seeking to derive the value of those bands. Critically, the revision of any spectrum charges is to be undertaken against the wider background and with a view to securing the purposes of the Direction itself. Thus, the Direction, if properly interpreted against the backdrop of the overarching regulatory scheme, provides a useful guide to Ofcom as to how it might set spectrum charges prospectively.

4.3 Vodafone recognises that Ofcom possesses the ability to review the value of spectrum bands so as to ensure that any spectrum charges are apt to secure their effective exploitation in the hands of existing licence holders. In undertaking an assessment, it is of course open for that regulator to consider all potentially relevant information. In that regard, as has been noted in the analysis undertaken by Frontier Economics, Vodafone accepts that the auction data, if properly analysed, can provide some valuable insights about the value of 900MHz spectrum band. Accordingly, to analyse the auction data robustly requires a much less formalistic interpretation of specific provisions of the Direction than that is exhibited in Ofcom's approach in the consultation document.

4.4 The table below summarizes Ofcom's formalistic interpretation of a number of critical phrases in the Direction and how this may distort its approach to setting spectrum charges:

Language of primary or secondary legislation	Ofcom's mis-construction of their meaning (in substance)	Relevant reference from ALF consultation	Effect of Ofcom approach
'reflect full market value'	'be set at a level implied by a value that is exactly equal to the market-clearing price'	2.8, 2.10	Failure to adjust for limitations inherent in the auction data when deriving value
'have particular regard to the sums bid for licences in the [UK 4G auction]'	'give over-riding weight to the sums bid for licences in the [UK 4G auction]'	2.15, 4.15. 4.16	Failure to adjust for limitations inherent in the auction data when deriving value
	'give exclusive consideration to auction values in general, over other forms of evidence as to the value of spectrum'	2.13, 2.15, Figure 4.1, 4.11, 4.12, 4.15.	Failure to consider other relevant issues such as the release of new spectrum, the differences between 800MHz and 900MHz spectrum and the role to be played by technical cost modelling in validating any conclusions drawn from the auction.

4.5 In the first instance, Ofcom fails to consider in any way what is intended by the Secretary of State through the use of terms such as 'have regard to the sums bid' and 'reflect full market value' when Ofcom seeks to set spectrum charges.

4.6 Neither expression connotes a hard obligation upon Ofcom, as a matter of construction according to their normal meaning. Although the literal meaning of reflection might imply a *mirroring*, it would be an over-reading of that term to suggest, in this context, that for Ofcom to 'reflect full market value' means that bidding data from an auction should be simplistically extracted and axiomatically be relied upon to determine market value without any reference to Ofcom's own duty to consider what would be an appropriate course to take in the circumstances. For a judgment of a court to 'reflect' the submissions made to it

by the parties, for example, does not suggest that those submissions are adopted uncritically; rather, it means that they have been considered, weighed up and taken into account, with a decision being adopted as to the extent to which such submissions should affect the final decision.

4.7 The Court of First Instance, in dealing with a closely analogous phrase (to take 'utmost account'), emphasised that a statutory decision-making body cannot abrogate its responsibility to exercise independent judgement in relation to a matter that it is required to take into account – and that such requirement to consider is not the same as the requirement to give effect to:

> *"Even though, in accordance with Article 7(5), the CMT must take 'the utmost account of comments of other [NRAs] and the Commission', it has some leeway to determine the content of the final measure, so that a Community act based on Article 7(3) of Directive 2002/21 cannot be regarded as directly affecting the legal situation of the undertakings concerned.*
>
> *Vodafone cannot claim that the fact that the NRA might not adopt the draft measure once the Commission's comments have been presented is only a theoretical possibility. Even if there is a strong probability that the NRA concerned will in fact adopt the draft measure,* ***it is for that authority alone to decide whether to adopt that measure and to determine its content****.*[13]*"*

4.8 Nor is there great interpretive value in parsing the distinctions between terms such as 'reflect', 'have regard to' (or 'particular regard to'), 'take into account' or 'take utmost account of'. While each must be construed on its own terms and in its own context, in this context, there is little practical distinction between them: they describe matters that Ofcom ought to have in mind when it reaches a view as to how to fulfil its statutory duties. They shape the exercise of that duty, but do not determine its course.

4.9 Considered in that context, the provisions of the Direction, if interpreted correctly, raise no particular legal concerns. Indeed, the correct interpretation of the Direction would mean that it would be open to Ofcom ultimately to exclude data from the auction if it concluded that the use of such data could not attain the purposes of the Direction or Ofcom's wider duties. That is, of course, logical since the Direction cannot interfere with the ability of an independent national regulator to determine how to ensure its statutory duties are achieved. However, as we discuss, it is Ofcom's failure to appreciate the context in which the provisions of the Direction exist that does give rise to material concerns.

4.10 The aforementioned provisions of the Direction must therefore be construed alongside the wider purposes of the Direction and Ofcom's obligations under the CRF, as transposed by the CA03 and WTA06 (giving effect to the CRF), when

[13] *Vodafone Espana v European Commission* (Case T-109/06) at 145 and 146. In that case, Vodafone sought to challenge a decision by the Commission to issue a 'serious doubts' letter as part of the process under Art 7 FD where the Commission may express views on proposed remedies and, in that case, the NRA must take 'utmost account' of those views.

managing spectrum (to which the Direction must also seek to give effect). That statutory regime places a great emphasis on the role of the national regulatory (or spectrum) agency as a deliberative body (albeit one subject to review of its decisions on the merits in accordance with Article of the 4 Framework Directive).

4.11 Accordingly, Ofcom must reflect upon the way in which the operative provisions of the Direction have been drafted by the Secretary of State. These provisions plainly imply a level of discretion or flexibility in the way that Ofcom should analyse and rely upon the auction data when seeking to determine market value of the 900MHz band. Occasionally, Ofcom itself appears to recognise this point when it acknowledges that it is able to consider data from overseas auctions when contemplating market value. But the overwhelming impression that Ofcom leaves for industry stakeholders is one in which it is able to do little more than extract bid data and then use such data mechanistically to calculate the value of the 900MHz band. This approach is then presented as a matter of regulatory judgment, when the reality is that the precise opposite is true; no judgment has been demonstrated at all as to how the Direction must operate in the legislative scheme.

4.12 This is not a matter of arcane legal theory. Ofcom's misconstruction of and formalistic approach to the Direction has very real consequences for the way in which it conducts its assessment in this case. Most notably:

4.12.1 It fails to take into account important limitations on the conclusions to be drawn about the auction and the bidding data that should be excluded from any analysis and calculations;

4.12.2 It appears unable to take into account new relevant information that may affect the value of the 900MHz spectrum band;;

4.12.3 It dismisses out of hand alternative ways of assessing market value of the 900MHz spectrum, even as a way of validating any conclusions drawn from the auction data;

4.12.4 It fails to examine the period over which spectrum charges should be set and how the term market value should be assessed and understood when setting a timeframe;

4.12.5 It fails to consider the impact of its proposed approach upon industry stakeholders and the consumers they serve.

4.13 That leads, logically, to consideration of most significant error of law that Ofcom makes in its analysis. That is Ofcom's clear failure to give effect to its own duties in the realm of spectrum management. Once Ofcom appreciates how the Direction must co-exist with its wider duties, it must draw the inescapable conclusion that its current approach to analysing and relying upon the auction data is simply not capable of discharging those duties.

4.14 The only appropriate way to interpret the Direction and apply it to the setting of spectrum charges is therefore to understand the wider legislative scheme and specifically the various duties that are relevant to the levying of spectrum charges. In section 5, we accordingly discuss the significance of Ofcom's various duties, the approach it takes in the ALF consultation and why any decision that proceeded along the lines set out in Ofcom's proposal would be based on a material and consequential error of law.

5. *Failure by Ofcom to demonstrate that the proposed approach to revising spectrum fees will attain its statutory obligations*

5.1 In light of the critique in section 4 of the way in which Ofcom has analysed the Direction, this Section 5 seeks to demonstrate how Ofcom might be able to rectify its flawed approach. Below, we examine how the Direction sits in the hierarchy of the regulatory framework and how that framework affects the way in which the Direction should be interpreted and applied when setting spectrum charges. Specifically, we consider the type of regulatory assessment that would be likely to attain the overarching objectives of the regulatory framework.

5.2 In the ALF consultation document Ofcom elects to recite the relevant provisions of the legal framework that it considers are relevant to the way in manages spectrum. Ofcom sets out in Section 2 (Introduction) and Section 3 (Factual Background and Legal Framework), what it considers to be the duties and obligations by which it is bound in relation to the ALF proposals. This includes an inter-dependent lengthy list of statutory instruments and other materials including EU Directives, UK primary legislation, regulations, government reports and Ofcom consultations:

5.2.1 Communications Act 2003 (the "CA03")

5.2.2 Wireless Telegraphy Act 2006 (the "WTA06").

5.2.3 The Wireless Telegraphy Act 2006 (Directions to OFCOM) Order 2010 (the "Direction");[14]

5.2.4 The Common Regulatory Framework for electronic communications networks and services, in particular the Framework Directive and the Authorisation Directive;

5.2.5 Two Ofcom competition assessments by Ofcom[15] culminating in an Ofcom Statement 24 July 2012 - *Assessment of future mobile competition and award of 800MHz and 2.6GHz*, published by Ofcom;[16]

5.2.6 Statement on proposals to make 900 MHz, 1800 MHz and 2100 MHz public wireless network licences tradable published by Ofcom on 20 June 2011;[17]

5.2.7 Ofcom statement - SRSP: The revised framework for Spectrum Pricing;[18]

[14] http://www.legislation.gov.uk/uksi/2010/3024/contents/made

[15] C*onsultation on assessment of future mobile competition and proposals for the award of 800 MHz and 2.6 GHz spectrum and related issues,* published by Ofcom on 22 March 2011 at http://stakeholders.ofcom.org.uk/consultations/combined-award/; *Second consultation on assessment on future mobile competition and proposals for the award of 800MHz and 2.6GHz spectrum and related issues*, published by Ofcom on 12 January 2012 at http://stakeholders.ofcom.org.uk/consultations/award-800mhz-2.6ghz/

[16] http://stakeholders.ofcom.org.uk/consultations/award-800mhz-2.6ghz/statement/

[17] http://stakeholders.ofcom.org.uk/binaries/consultations/trading-900-1800-2100/statement/900-1800-2100-statement.pdf

5.2.8 Interim and Final Digital Britain Report(s);[19]

5.2.9 Government consultation on a Direction to Ofcom to Implement the Wireless Radio Spectrum Modernisation Programme[20] and Government Response to the Consultation on a Direction to Ofcom to Implement the Wireless Radio Spectrum Modernisation Programme.[21]

5.3 Ofcom cites the Access Directive (Directive 2002/19/EC), the Universal Service Directive (Directive 2002/22/EC) and the Directive on privacy and electronic communications also (Directive 2002/58/EC), as amended by the Better Regulation Directive (Directive 2009/140/EC) but no further reference is made to these Directives in the ALF consultation.

5.4 In Sections 2 and 3 of the ALF consultation Ofcom recites the provisions of the legal framework that it considers are relevant to the revision of the 900 MHz and 1800 MHz spectrum licences and the development and issuing of a statement amending those licences. The mere recital of a lengthy list of duties and obligations is, however, insufficient to establish that Ofcom has actually considered how these duties have been secured in the approach to setting spectrum charges. In particular, Ofcom fails to demonstrate that it properly had regard to the hierarchy of the obligations in this framework and how that hierarchy affects the appropriate approach to be adopted. The consequence of Ofcom's approach is that it has:

5.4.1 omitted duties and obligations; and/or

5.4.2 misapplied duties and obligations;

and has consequently failed to provide a sufficiently robust and rigorous legal justification to its decisions in relation to the proposed amendments to the ALF. There is therefore no sound legal basis for Ofcom's proposals.

5.5 At Appendix 2 to this Annex is a table for comparison of Ofcom's relevant obligations and duties. The table identifies the extent to which Ofcom has:

5.5.1 Referenced or omitted its obligations and duties;

5.5.2 Incorrectly referred to its obligations and duties;

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[18] http://stakeholders.ofcom.org.uk/consultations/srsp/

[19] http://webarchive.nationalarchives.gov.uk/20100511084737/http://www.culture.gov.uk/what_we_do/broadcasting/5944.aspx; http://www.bis.gov.uk/assets/biscore/corporate/docs/d/digital-britain-final-report.pdf

[20] http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/consultations/ofcom-wireless-modernisation-programme

[21] http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/assets/biscore/business-sectors/docs/10-737-government-response-consultation-ofcom-implement-spectrum-modernisation

5.5.3 Referenced but not addressed its obligations and duties. [22]

5.6 Without fully replicating the task Ofcom should undertake, we include some preliminary observations about Ofcom's relevant duties.

Principles governing Ofcom's decision making

5.7 The starting point for understanding the legal framework which governs Ofcom's conduct in setting spectrum charges is the CRF, which in the UK has been transposed via (in this context) the CA03 and WTA06. Any approach to setting spectrum charges must thus always ensure that it attains objectives that are mandated by Community law and that any domestic implementing legislation should be construed to give effect to those Community law obligations.

5.8 The CRF recognises that spectrum is a scarce resource and a key input to the provision of communications services to end users. The way in which it is allocated and managed on an ongoing basis will therefore have material consequences for the structure and future of development of markets, the intensity of competition and ultimately the welfare of consumers. This is no doubt why the Community legislature imposed significant safeguards upon the behaviour of independent national regulators if they contemplated the setting of fees for the right of use of radio frequencies. The Authorisation Directive, and in particular Article 13, are particularly instructive and relevant:

> *"Member States may allow the relevant authority to impose fees for the rights of use for radio frequencies or numbers or rights to install facilities on, over or under public or private property which reflect the need to ensure the optimal use of these resources. Member States shall ensure that such fees shall be objectively justified, transparent, non-discriminatory and proportionate in relation to their intended purpose and shall take into account the objectives in Article 8 of Directive 2002/21/EC (Framework Directive)."*

5.9 It is noteworthy that any fees must, *in the first instance,* be transparent, objectively proportionate 'to their intended purpose', which makes it clear that the imposition of fees under Article 13 (which is an inherently intrusive form of intervention) must be:

5.9.1 capable of being reasoned (in a way that is comprehensible to industry stakeholders) and supported by credible evidence;

5.9.2 The least onerous or intrusive approach to ensure that the given policy objective is realised.

5.10 In respect of (1) above, the lack of clear reasoning and repeated reliance on 'regulatory judgment' is a recurrent theme in this consultation document. Also conspicuous for its absence is Ofcom's purpose or objective in setting spectrum

[22] Vodafone does not consider that every single omission in Ofcom's analysis is material, and restricts its submission to those manifest errors that might reasonably colour Ofcom's proposals or where repair of Ofcom's chain of logic has a material effect on the overall approach or outcome.

charges that is contemplated by (2), beyond, it would appear, mechanistically applying specific provisions of the Direction. Finally, there is no indication that Ofcom has considered – assuming that it is able to articulate a policy objective – that its proposed approach will ensure that the lowest possible burden is imposed upon licensee whilst still ensuring that optimal use of spectrum is secured. The only prudent way in which this analysis can be undertaken is through an impact assessment that seeks to measure the effect of particular policy approaches upon industry stakeholders and consumers.

5.11 The importance of proportionality in setting spectrum fees is reinforced by the Recitals to the Authorisation, which serve as important aid to understanding the thinking of the Community legislature. Recital 11 of the Authorisation Directive (which is not mentioned in Ofcom's document) provides that:

> *The granting of specific rights may continue to be necessary for the use of radio frequencies and numbers, including short codes, from the national numbering plan. Rights to numbers may also be allocated from a European numbering plan, including for example the virtual country code '3883' which has been attributed to member countries of the European Conference of Post and Telecommunications (CEPT).* ***Those rights of use should not be restricted except where this is unavoidable in view of the scarcity of radio frequencies and the need to ensure the efficient use thereof.*** **[emphasis added]**

5.12 The final sentence of this recital makes it clear that spectrum licence rights (including the right to pay fees) should only be applied where this is unavoidable – in other words, where there is a clear necessity to do so driven by the scarcity of frequencies and the need to ensure spectrum efficiency. This emphasises the distinction between, for example, the setting of conditions following a finding of significant market power where Ofcom has a relatively wider zone of discretion to adopt rules in certain circumstances, and the relatively more limited scope that exists to do in relation to (in this context) spectrum rights.

5.13 This same point is reiterated in Recital 15 (once again not cited in Ofcom's document):

> *The conditions, which may be attached to the general authorisation and to the specific rights of use, should be* ***limited to what is strictly necessary*** *to ensure compliance with requirements and obligations under Community law and national law in accordance with Community law.*

5.14 The recitals (specifically 32 and 33) are equally informative about the purposes underpinning the levying of such fees and the circumstances in which fees might be altered:

> *(32)* ***In addition to administrative charges, usage fees may be levied for the use of radio frequencies and numbers as an instrument to ensure***

the optimal use of such resources. Such fees should not hinder the development of innovative services and competition in the market. *This Directive is without prejudice to the purpose for which fees for rights of use are employed. Such fees may for instance be used to finance activities of national regulatory authorities that cannot be covered by administrative charges. Where, in the case of competitive or comparative selection procedures, fees for rights of use for radio frequencies consist entirely or partly of a one-off amount, payment arrangements should ensure that such fees do not in practice lead to selection on the basis of criteria unrelated to the objective of ensuring optimal use of radio frequencies. The Commission may publish on a regular basis benchmark studies with regard to best practices for the assignment of radio frequencies, the assignment of numbers or the granting of rights of way.*

"(33) Member States may need to amend rights, conditions, procedures, charges and fees relating to general authorisations and rights of use where this is objectively justified. Such changes should be duly notified to all interested parties in good time, giving them adequate opportunity to express their views on any such amendments."

5.15 Thus, it is clear firstly that the right to impose spectrum fees does not exist in a regulatory vacuum. Such charges are only permitted to the extent they are able to produce a wider benefit. Plainly if spectrum charges were not to incentivise exploitation of spectrum or deterred development of products or services, such charges could not, on any analysis, be deemed to be welfare-enhancing. Secondly, where a national regulator chooses to amend charges levied for rights of use, it must have clear and compelling reasoning for so doing. Reliance on the existence of one specific provision of a domestic legislative instrument or the concept 'regulatory judgment' cannot, of itself, represent the objective justification that is contemplated by Recital 33.

5.16 To ensure that national regulators are capable of being held accountable when providing such an objective justification, the CRF imposes basic requirements of transparency:

"Member States shall ensure that the rights, conditions and procedures concerning general authorisations and rights of use or rights to install facilities may only be amended in objectively justified cases and in a proportionate manner, taking into consideration, where appropriate, the specific conditions applicable to transferable rights of use for radio frequencies. Except where proposed amendments are minor and have been agreed with the holder of the rights or general authorisation, notice shall be given in an appropriate manner of the intention to make such amendments and interested parties, including users and consumers, shall be allowed a sufficient period of time to express their views on the proposed amendments, which shall be no less than four weeks except in exceptional circumstances."

5.17 Article 14 makes clear the necessity of an open and complete consultation in relation to any amendment to spectrum licence conditions. This requirement is only met where that consultation is sufficiently clear and detailed so as to enable meaningful responses, and so Ofcom's duty of transparency is engaged in relation to that process.

5.18 Article 13 also provides further significant reference points that are intended to guide national regulators when setting spectrum charges. Through the explicit link between Article 13 of the Authorisation Directive and Article 8 of the Framework Directive, the Community legislature has effectively recognised the importance of spectrum to the evolution of communications services markets. National regulators can be in little doubt as to what their primary objective should be through a simple review of the provisions of Article 8:

> *"2. The national regulatory authorities shall promote competition in the provision of electronic communications networks, electronic communications services and associated facilities and services by inter alia:*
>
> *(a)* ***ensuring that users, including disabled users, elderly users, and users with special social needs derive maximum benefit in terms of choice, price, and quality****;*
> *(b) ensuring that there is no distortion or restriction of competition in the electronic communications sector, including the transmission of content;*
> *[(c) repealed in 2009 revisions]*
> *(d)* ***encouraging efficient use and ensuring the effective management of radio frequencies and numbering resources****.*
>
> *5. The national regulatory authorities shall, in pursuit of the policy objectives referred to in paragraphs 2, 3 and 4, apply objective, transparent, non-discriminatory and proportionate regulatory principles by, inter alia:*
>
> *(a)* ***promoting regulatory predictability by ensuring a consistent regulatory approach over appropriate review periods****;*
> *(b) ensuring that, in similar circumstances, there is no discrimination in the treatment of undertakings providing electronic communications networks and services;*
> *(c) safeguarding competition to the benefit of consumers and promoting, where appropriate, infrastructure-based competition;*
> *(d)* ***promoting efficient investment*** *and innovation in new and enhanced infrastructures, including by ensuring that any access obligation takes appropriate account of the risk incurred by the investing undertakings and by permitting various cooperative arrangements between investors and parties seeking access to diversify the risk of investment, whilst ensuring that competition in the market and the principle of non-discrimination are preserved;*
> *(e) taking due account of the variety of conditions relating to competition and consumers that exist in the various geographic areas within a Member State;*

(f) imposing ex-ante regulatory obligations only where there is no effective and sustainable competition and relaxing or lifting such obligations as soon as that condition is fulfilled." [emphasis added]

5.19 The relevance of the Article 8 provisions to the management of radio spectrum is further reinforced by Article 9 of the Framework Directive, which provides that:

"Taking due account of the fact that radio frequencies are a public good that has an important social, cultural and economic value, Member States shall ensure the effective management of radio frequencies for electronic communication services in their territory in accordance with Articles 8 and 8a. They shall ensure that spectrum allocation used for electronic communications services and issuing general authorisations or individual rights of use of such radio frequencies by competent national authorities are based on objective, transparent, non-discriminatory and proportionate criteria."

The UK regime - Ofcom's Community law obligations

5.20 The objectives and obligations of the CRF are given effect in UK law through the Communications Act 2006 and the Wireless Telegraphy Act 2006. The Communications Act, which establishes Ofcom and its functions, in particular identifies the significance of spectrum from the outset:

"…*to make provision about the regulation of the use of the electro-magnetic spectrum*"[23]

and confers on Ofcom its power to act in accordance with its duties. Ofcom's functions under the CA03 must be carried out by reference to and in accordance with its principal duty under that enactment.

5.21 When carrying out certain functions arising under the CRF, Ofcom must act in accordance with the six Community requirements set out in section 4 CA03.

5.22 The six Community requirements are:

5.22.1 To promote competition in markets within its jurisdiction;[24]

5.22.2 To contribute to the development of the European internal market;

5.22.3 To promote the interests of citizens of the European Union;

[23] Preamble, CA03. This is a simplification for brevity – being precise, Ofcom's regulatory functions are established under the CA03; Ofcom itself was established by the Office of Communications Act 2002.

[24] Ofcom is obliged to promote competition (by virtue of the first Community requirement) in relation to the provision of electronic communications networks and electronic communications services ('ECN/ECS'), services and facilities that are provided or made available in association with ECN/ECS and directories capable of being used in connection with ECN/ECS (CA03, section 4(3)(a) to (c)).

5.22.4 To take account of the desirability of Ofcom carrying out its functions in a way does not favour a specific technology or means of providing or making available a network, service or facility;

5.22.5 To encourage the provision of network access and service interoperability, to the extent that Ofcom considers it appropriate for the purposes of securing efficiency and sustainable competition; efficient investment and innovation; and the maximum benefit for the purposes of end-users;

5.22.6 To encourage compliance with technical standards as necessary to facilitate service interoperability and securing freedom of choice.[25]

5.23 As with Ofcom's general duties, on close reading, it is apparent that not all the Community requirements are alike:

5.23.1 Ofcom's first three Community requirements are 'required outcomes' under section 3(2). They constitute legitimate objectives or purposes that must be pursued by the exercise of Ofcom's functions under the CRF. Art 8 FD makes this clear, referring to:

> *"Member States shall ensure that in carrying out the regulatory tasks specified in this Directive and the Specific Directives, the national regulatory authorities take all reasonable measures which are aimed at achieving the objectives set out in paragraphs 2, 3 and 4. Such measures shall be proportionate to those objectives."*

5.23.2 The fourth Community requirement requires Ofcom to take account of a desirable outcome, but does not require that Ofcom act in pursuit of that outcome (unlike the first, second and third requirements which – read in light of Article 8 of the Framework Directive – it is clear that Ofcom must adopt as objectives or purposes for its actions).

5.23.3 The fifth and sixth Community duties are relatively narrow in their focus on inter-operator arrangements and technical regulation and are, in any event, a requirement to encourage certain activities, not to secure that those activities are undertaken.

5.24 The Community requirements are (as their name implies) mandatory and individually imposed and they are, therefore, cumulative – that is, although in most circumstances, only a subset of them may be relevant (and hence may not bite), it is normally the case that Ofcom would not expect to take an action that was incompatible with any of them.

5.25 Therefore, the Community requirements are (when they are engaged) a significant constraint, since any action falling within the scope of section 4(1)

[25] The technical standards are those specified in CA03 section 4(10) and include those endorsed by European and international standards-setting agencies.

(even if it furthers Ofcom's principal duty) must be taken in accordance with all of those requirements.

5.26 In considering any action under the CRF, therefore, Ofcom should ask itself: Is it acting with a purpose or objective in mind that is in accordance with those requirements? And is the action it is proposing to take pursuant to that objective or purpose an action that is 'in accordance with' each of the Community requirements?

Duties under the WTA06

5.27 In light of the preceding analysis, it is clear that the duties imposed under section 3 WTA06 are supplemental and once again largely reflective of the objectives of the CRF:

> *"3(1) In carrying out their radio spectrum functions, OFCOM must have regard, in particular, to–*
>
> > *(a) the extent to which the electromagnetic spectrum is available for use, or further use, for wireless telegraphy;*
> >
> > *(b) the demand for use of the spectrum for wireless telegraphy; and*
> >
> > *(c) the demand that is likely to arise in future for the use of the spectrum for wireless telegraphy.*
>
> *3(2) In carrying out those functions, they must also have regard, in particular, to the desirability of promoting–*
>
> > *(a) the efficient management and use of the part of the electromagnetic spectrum available for wireless telegraphy;*
> >
> > *(b) the economic and other benefits that may arise from the use of wireless telegraphy;*
> >
> > *(c) the development of innovative services; and*
> >
> > *(d) competition in the provision of electronic communications services."*

5.28 These duties are engaged only when and to the extent that Ofcom is carrying out a 'radio spectrum function' including, in this context, making regulations contemplated under section 12(1)(b) governing the payment of spectrum licence fees.[26]

[26] Part 1 of WTA06 is titled 'Radio spectrum functions of Ofcom'. Although section 12 does not form part of Part 1, section 5 WTA06 provides that 'The Secretary of State may be order give general or specific directions to Ofcom about the carrying out by them of their radio spectrum functions' and section 5(4)(b) specifies section 12 as one of the provisions falling within the scope of powers

5.29 Section 3 WTA06 does not itself impose a duty to carry out radio spectrum functions, merely provide that when Ofcom does so, it must do so in certain ways or having regard to certain matters. They speak to how, not when or why, those functions might be performed.

5.30 Therefore, the implication is that the motive force for those functions - Ofcom's objective or purpose in carrying out their radio spectrum functions - must flow from Ofcom's principal duty (most obviously, Ofcom's duty to secure the optimal use of spectrum, which section 3(2) constitutes a necessary element of the principal duty). That purpose or objective may also be conditioned by one or more of Ofcom's Community requirements (and, as we shall see, the requirements of section 5 WTA06).

5.31 Section 13 WTA06 narrows Ofcom's discretion in relation to the general exercise of its radio spectrum functions under section 12 WTA06 (dealing with spectrum licence fees) in that Ofcom 'may, if they think fit in the 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.'

5.32 Ofcom mis-characterises this provision as requiring it to take account of matters under section 3 CA03; in fact, the correct position in law is that section 13 WTA 06 refers to section 3 WTA06. This is important because it suggests that Ofcom may have misunderstood which statutory provisions govern the matters to which it must have regard when setting licence fees above its costs. Any decision to proceed that was not based on a true understanding of the relevant statutory provisions, including the restrictions those provisions place on what matters are relevant to consider in making that decision, would be *ultra vires*.[27]

5.33 Vodafone is also concerned that, in any event, the matters set out in sections 3(1) and 3(2) WTA06 are precisely those matters (such as future demand for spectrum) where Ofcom's ALF proposals appear to side-step the statutory requirements for rigorous analysis to inform the exercise of Ofcom's powers. The rationale given for Ofcom's approach is, in essence, to cite the presence of the Direction. Given that it is unarguable that Ofcom ought to analyse those matters (such as the impact on consumers and on competition and including for example, taking account of the evidence that Ofcom has already amassed, summarised in section 2 of this submission) if the Direction did not exist, we submit that it is a misconstruction of the Direction to read it as removing the need for that analysis (although it may affect the way in which that analysis is used).

5.34 The approach in the ALF proposals is also inconsistent with Ofcom's approach in other matters pertaining to the exercise of its radio spectrum functions. For

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exercisable by Ofcom that may be the subject of a direction (section 5(3)). Ofcom does not dispute that setting regulations under section 12 constitutes the exercise by Ofcom of a 'radio spectrum function' (see for example the ALF consultation, at paragraphs 3.26 and 3.31).

[27] ALF consultation, paragraph 3.29.

example, in its wider strategy document (published just a week before the ALF consultation), Ofcom stresses that:

> *Alongside our principal duty and securing optimal use of spectrum, we have a wide range of other duties (set out in the Communications Act 2003 and the Wireless Telegraphy Act 2006) that are relevant to, and impact our spectrum decisions.*
>
> *[…]*
>
> *When taking decisions on spectrum matters we consider all relevant duties, alongside those that are directly related to our spectrum functions.*[28]

Ofcom's general duties when undertaking its functions

5.35 Importantly, Parliament has buttressed these Community law obligations by providing for a series of general duties and obligations that are applicable in any case when it is performing its function under a given statutory provision. Section 3(1) of the Communications Act provides that it is Ofcom's principal duty to:

> *(a) to further the interests of citizens in communications markets; and*
>
> *(b) to further the interests of consumers in relevant markets, where appropriate, by promoting competition*

5.36 This principal duty requires that (to the extent that Ofcom has discretion) Ofcom's actions should always further the interests of consumers and citizens; conversely, in circumstances where a proposed action is not in the interests of consumers and citizens, Ofcom is duty-bound not to take that action. It follows that, in all circumstances where Ofcom has discretion as to a course of action, even where it is obliged to act and has only limited discretion, the starting point must be to ask itself: what course of action most effectively furthers the interests of consumers and citizens?

5.37 Section 3(2) CA03 provides that Ofcom's principal duty includes the requirement to secure certain outcomes (three of which are relevant to the ALF consultation):

> *(a) the optimal use for wireless telegraphy of the electro-magnetic spectrum;*
>
> *(b) the availability throughout the United Kingdom of a wide range of electronic communications services;*
>
> *(c) the availability throughout the United Kingdom of a wide range of television and radio services which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests;*

5.38 Ofcom is required to secure these outcomes not as a result of the direct imposition of a separate duty but 'by virtue of subsection (1)'. In other words

[28] Ofcom's *Spectrum Management Strategy* consultation, at paragraphs 4.4 and 4.5.

section 3(1) is attained where the objectives in section 3(2) are realised. It follows that these outcomes therefore must (as a matter of statutory construction) be understood to further the interests of consumers and citizens.

5.39 Section 3 CA03 is titled 'General duties'. Apart from Ofcom's principal duty, Ofcom's other general duties include:

5.39.1 The duty, when performing its principal duty, to have regard to principles of consistency and best regulatory practice (under section 3(3) CA03);

5.39.2 The duty, when performing its principal duty, to have regard to such matters listed in section 3(4) as may appear to Ofcom to be relevant. Most of the items listed are desirable outcomes or factors to take into account in certain circumstances (e.g. 'the needs of persons with disabilities, of the elderly and of those on low incomes')[29]. Most relevant is a requirement to consider whether a particular course of action promotes investment and innovation; and

5.39.3 A provision prescribing matters to be considered when considering the interests of consumers.

5.40 Ofcom's general duties are not all imposed in equal terms. The principal duty, and the outcomes that, by virtue of the principal duty, Ofcom is required to secure, are paramount. Amongst the general duties, only this principal duty sets an objective or purpose for Ofcom's actions. The other general duties are contextual, relevant only in certain circumstances and are engaged only in the event that the principal duty is already engaged. They govern how Ofcom might perform its principal duty, including the processes and principals it might adopt and the factors it might take into account, depending on the circumstances.

5.41 Critically, the 'desirable outcomes' listed in section 3(4) cannot be treated in equivalent terms to the 'required outcomes' in section 3(2):

5.41.1 The desirable outcomes are merely matters that Ofcom may have regard to; Ofcom is 'required' to secure the required outcomes.

5.41.2 Those desirable outcomes are not relevant by direct reference to or 'by virtue of' Ofcom's principal duty but because Ofcom must have regard to them when carrying out its principal duty. The desirable outcomes are therefore not necessarily outcomes which must be treated as furthering the interests of consumers, as a matter of statutory construction: instead, the question of how and whether those desirable outcomes do, in any given context, further the interests of consumers is a matter that Ofcom must consider on the evidence. It cannot simply be taken as given.

[29] We note that section 3(4)(g) appears to be an exception (the matter it requires Ofcom to have regard to is a 'need' rather than a desirable state of affairs). The subject matter (freedom of speech) is, by its nature, exceptional in the context of communications regulation and in any event, it is not relevant to the ALF consultation.

5.42 Therefore, in considering a course of action, Ofcom ought to ask itself: what is the purpose or objective for a particular policy approach. This purpose or objective should be derived directly from Ofcom's principal duty. It should then ask itself: given my objective or purpose, which, if any, of the duties imposed by sections 3(3), 3(4) and 3(5) are relevant to the facts of this case? And of those that are relevant, how do they affect the exercise of the principal duty – that is, how do they affect the interests of consumers and/or citizens, or the procedure that Ofcom might adopt to assess the interests of consumers and/or citizens?

Ofcom's procedural and evidentiary duties

5.43 In tandem, any decisions must be objectively justifiable, that is provided on a sufficient factual and robust evidential bases and transparent reasoning to justify the decision satisfies the objectives. Ofcom's decisions must be proportionate and non-discriminatory, technologically neutral and promote regulatory predictability by ensuring a consistent regulatory approach.[30]

5.44 Proportionality requires legitimacy, suitability and necessity, so that:

> *(i) the legislative objective is sufficiently important to justify limiting a fundamental right; (ii) the measures designed to meet the legislative objective are rationally connected to it; and (iii) the means used to impair the right or freedom are no more than is necessary to accomplish the objective.*[31]

The Direction

5.45 The Direction, which is central to Ofcom's approach, must therefore be considered in the wider regulatory context described above and must be deemed to attain Ofcom's obligations under Community law as well as those additional duties overlaid by Parliament. We now scrutinise the relevant provisions of the Direction and explain which elements of the Direction take precedence for the purposes of interpretation and subsequent application.

5.46 The Direction has been issued pursuant to section 5 WTA06 provides for the Secretary of State to give directions to Ofcom about the carrying out by them of their radio spectrum functions. It provides that such an order may 'require Ofcom to exercise their powers under [section 12] –

> *(a) in such cases*
>
> *(b) in such manner*
>
> *(c) subject to such restrictions and constraints, and*
>
> (d) *with a view to achieving such purposes*,'
>
> as are specified in that order.

[30] FD Article 8(5), CA03, sections 3(3) and 4(6).
[31] *Daly* [2001] UKHL 26 [2001] 2 AC 532 at [27], *citing De Freitas* [1999] AC 69, 80F-G

5.47 The most important element of section 5 is the reference to the purposes of any Direction issued by the Secretary of State. As has already been demonstrated clearly, any purpose must (whether implicitly or explicitly) operate to achieve Ofcom's Community law obligations in relation to spectrum as well as its wider general duties. The table below summarises the relevant sections of the Direction, relevant to the ALF consultation that map onto the provisions of section 5 WTA06.

Requirement of section 5 WTA06	5.48 Text of the Direction	5.49 Discussed in the ALF consultation?
In such cases In such manner	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.	5.50 Yes
Subject to such restrictions and constraints	5.51 6(2) In revising the sums prescribed OFCOM must have particular regard to the sums bid for licences in the Auction.	5.52 Yes
With a view to achieving such purposes	2. The Secretary of State gives these directions for the purposes of: ensuring the release of additional electromagnetic spectrum for use by providers of next generation wireless mobile broadband; allowing early deployment and maximising the coverage of those services; creating greater investment certainty for operators; and implementing Directive 2009/114/EC(b) and the Decision(c) on the liberalisation of frequencies in the 900MHz and 1800MHz bands.	No

The purposes of the Direction

5.53 There are four purposes set out in the Direction:

5.53.1 ensuring the release of additional electromagnetic spectrum for use by providers of next generation wireless mobile broadband;

5.53.2 allowing early deployment and maximising the coverage of those services

5.53.3 creating greater investment certainty for operators; and

5.53.4 implementing Directive 2009/114/EC(1) and the Decision(2) on the liberalisation of frequencies in the 900MHz and 1800MHz bands.

5.54 These purposes are entirely logical and reasonable in the context of the CRF, the Communications Act and the Wireless Telegraphy Act. Indeed, the maximising of coverage and promoting greater investment certainty are naturally intertwined since greater investment certainty is almost certainly more likely to enhance the prospects of expanded coverage the deployment of new services. As can be seen below, even considered disjunctively, they clearly are entirely consistent with the provisions of the wider regulatory regime:

5.54.1 The reference to investment certainty would be consistent with Ofcom's obligation in Article 8 of the Framework Directive to promote efficient investment and innovation and further reinforces Ofcom's general duty in section 3(4) to act in a way that promotes investment. It plainly implies that the Secretary of State would have expected Ofcom to act in a way that gave licensees the certainty that is a pre-requisite to take planning and investment decisions over the medium and long term given that investment should promote expansion and diffusion of new products and services for consumers.

5.54.2 Equally, enabling the deployment of new services and maximising coverage plainly operate to the benefit of mobile consumers, outcomes that are required by virtue of Article 8 of the Framework Directive and section 3(2) CA03.

5.55 Accordingly, there is nothing in the Direction that would be in conflict with Ofcom's Community law and general duties. The question that Ofcom must then seek to address is the objectives that would be relevant when setting spectrum charges. As a matter of fact, the first objective of the Direction and the fourth, have already been achieved; the other purposes relevant to the setting of spectrum charges are '*creating greater investment certainty for operators*' and '*allowing early deployment and maximising coverage* [of next generation services].

5.56 Ofcom does not at any point appear to recognise these objectives or articulate what purpose its proposed approach to setting spectrum charges will serve. Deductively, applying section 5 WTA 06 and by virtue of the fact that the purposes map onto the various tasks assigned to Ofcom in the Direction, Ofcom's actions in revising the ALF to give effect to section 6(1) must therefore be with a view to achieving the purpose of creating greater investment certainty for operators and to facilitate, where possible, the early deployment of next

generation services and maximising coverage.[32] Accordingly, when Ofcom analyses the proposal in the Direction to revise spectrum charges to 'reflect full market value' with particular regard to the 'sums bid' in the recent auction, it must recognise that these terms are quite deliberately drafted in a broad way so as to enable Ofcom to satisfy itself that use of the auction data and any conclusions reached from assessing such data must always secure the objectives of the Direction.

5.57 The effect of the provisions relating to the way in which Ofcom might wish to revise spectrum charges (section 6(1)) is to do no more than *invite* Ofcom to consider the relevance of the recent auction when setting spectrum fees. They quite clearly do not require Ofcom to use bids in the auction or even conclude that such bids made in February 2013 represent the exact market value of the 900MHz band both now and prospectively. As we explain further below and elsewhere in our submission, market value is a fluid concept that is capable of evolving with changes in circumstances (such as technological developments). Were the Direction to operate in a way that precluded Ofcom from adopting a purposive approach to the setting of spectrum charges, it would require Ofcom to undertake little more than an arithmetical exercise with little consideration for its wider duties and obligations. That outcome would amount to improper and impermissible interference with the conduct of the regulator.

5.58 There is no evidence that Ofcom has properly turned its mind to the correct significance of section 2 of the Direction in light of section 5(3)(d) WTA06 (which is not cited or mentioned at all) when it has formulated its approach to the setting of spectrum charges. Instead, it has focused exclusively on the provisions of the Direction governing the way in which 'market value' might be calculated. This constitutes a serious error of law which, alone, would be sufficient to render Ofcom's ALF proposal incapable of supporting a decision to impose increased licence fees.

How must Ofcom address its obligations and duties?

5.59 It is not sufficient for Ofcom to merely refer its obligations and duties without adequately specifying their relevance to the particular subject under consideration and detailing how it has taken them into account in its analysis and conclusions. The obligations of transparency, proportionality and accountability reinforce the duty on Ofcom to provide rigorous and transparent justification for each step in its decisions. As the Competition Appeal Tribunal commented in *TRD* at paragraph 187:

[32] If Ofcom considers that the obligation to maximise coverage of next generation services through the imposition of a coverage obligation in one of the 4G licences, that position is not valid. The Direction refers to the maximising of coverage of services (plural). Moreover, Ofcom must consider as part of its Impact Assessment the extent to which alternative levels of spectrum charges might facilitate the expansion of these services more speedily than might otherwise occur. To the extent that lower spectrum charges, for instance, secure such an outcome, that is logically a consumer benefit to which Ofcom must attach considerable weight.

> *… the Tribunal would expect to see some discussion of which of the general duties set out in section 3 and which of the Community requirements set out in section 4 of the 2003 Act (read together with article 8 of the Framework Directive) are particularly engaged by the issues raised in the dispute and how the proposed resolution of the dispute accords with those objectives. It is not sufficient simply to refer to the relevant provisions of the legislation in general terms when many are of little relevance to issues raised by the dispute.* [emphasis added]

5.60 Ofcom's primary objectives must guide it from the outset, that is, at the preliminary stages of the analysis and in particular through the consultations stages. It cannot be correct that 'subordinate duties' or 'peripheral obligations' guide Ofcom in developing its approach so that it is not in a position to be confident whether or not its principal duties are met by the end of the process (even if they are). This would be putting the cart before the horse. The CAT has raised this concern previously with Ofcom:

> *… the next main question is whether Ofcom gave adequate consideration to the full range of its regulatory duties, powers and responsibilities under both EU and domestic law…. the question is one of substance, not form. Thus it does not necessarily matter if Ofcom set about its task by forming a preliminary conclusion, on the basis of the factors to which it attached primary significance, and then testing that conclusion in the light of other relevant considerations to see if it needed to be modified or rejected.*[33]

5.61 The question in this context is whether Ofcom has, in this preliminary stage of developing its conclusion, provided appropriate consideration to factors of primary importance.

Has Ofcom afforded its obligations and duties adequate consideration?

5.62 In reviewing whether Ofcom has discharged its principal duty Ofcom must demonstrate that it has afforded them *adequate consideration*. As a preliminary test we have analysed the discussion of Ofcom's duties in the ALF consultation document. Ofcom listed 41 duties in the consultation document and failed to identify 15 and referred to 8 incorrectly that are relevant to the setting of ALF.

5.63 Encouraging and promoting investment is a policy objective that Ofcom must pursue. In discharging its primary functions, in particular, promoting competition, Ofcom "*must have regard to the desirability of encouraging investment*".[34] The fifth Community requirement, requires that it:

> *"shall be the duty of Ofcom in carrying out its functions, to secure network access and service interoperability by encouraging efficient investment"*.[35]

[33] Telefonica UK v Ofcom [2012] CAT 28 (*Flip-flopping*) at 103.
[34] Section 3(4)(d), CA03
[35] Section 4(7) CA03

5.64 Art 8(2)(d) of the Framework Directive requires Ofcom to apply objective, transparent and non-discriminatory and proportionate regulatory principles by:

> *(d) promoting efficient investment and innovation in new and enhanced infrastructures, including by ensuring that any access obligation takes appropriate account of the risk incurred by the investing undertakings and by permitting various cooperative arrangements between investors and parties seeking access to diversify the risk of investment, whilst ensuring that competition in the market and the principle of non-discrimination are preserved*
>
> In addition, section 2 of the Direction reinforces this principle by stating that a main purpose of the Direction is "*creating greater investment certainty for operators*".

5.65 While *investment* appears five times in the table listing Ofcom's duties that are engaged in relation to the ALF, it appears once in the body of the ALF consultation in relation to any analysis.[36] While *investment* is referred to a number of times in Annex 9 of the consultation document, here Ofcom merely discusses the concerns of stakeholders that there is an asymmetric risk of the ALF being set too high. Thus Annex 9 of the consultation document responds to submissions previously made by current licence holders but it does not appear to form part or have bearing on Ofcom's analysis or consideration of the appropriate ALF.

5.66 Section 6(1) of the Direction specifies that:

> *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.*

5.67 By comparison the words 'market value' appear 139 times in the ALF consultation, but appear only once in Ofcom's duties – in section 6(1) of the Direction. 'Market value' appears eight times in Section 1, while "consumers" and "investment" do not appear (beyond by reference to Ofcom's duties) in any analysis in the ALF consultation until each is mentioned in section 5.

5.68 There is no evidence that Ofcom has undertaken a proper analysis of the legal context within which any decision on spectrum charges would be taken. Specifically, Ofcom's construction of the Direction and the relevant legislation fails to properly place the obligation imposed by section 6(1) of the Direction in context alongside other important statutory obligations and duties. The perceived requirement of the Direction to set licence fees at market value (construed narrowly) is permitted to drive the consultation in isolation – a legal mistake that colours much of the analysis presented in the document.

[36] Paragraph 6.21

Ofcom ought first to decide what it is trying to achieve

5.69 As a matter of proper statutory construction, Ofcom has a duty to ask itself questions in the right sequence.[37] The first question Ofcom should ask itself: **for what purpose or objective are we duty-bound to act, in this context?**

5.70 The purpose of Ofcom's action is separate from the question of what other general and specific duties are engaged when acting pursuant to that purpose. Normally, Ofcom's purpose or objective will flow from Ofcom's principal duty – their objective shall be to further the interests of consumers. The only reason why that might not be the case is where there is some specific legal obligation to do otherwise (such as the need to comply with a direction).

5.71 It is necessary in law to be clear as to the purpose or objective of action because:

5.71.1 An action that is undertaken for an improper purpose will be *ultra vires*, even if it were otherwise capable of being lawfully undertaken; and

5.71.2 Without clarity as the purpose or objective, it is not possible to assess the proportionality of the action in light of that objective.[38]

5.71.3 To the extent that Ofcom resolves conflicts between its duties (as it is required to do under, for example, section 3(7) in relation to its general duties), it can only do so to the extent that it has a clear and properly formed view of its purpose or objective.

5.72 Ofcom should be well aware of the need to be clear about its statutory objective. In the *TRD* case, the following reasoning clarifies the position:

> *94. T-Mobile and OFCOM referred us to the case of Derbyshire Waste Limited v Blewett [2004] EWCA (Civ) 1508 in which the Court of Appeal considered the influence that the objectives set out in the EC Waste Framework Directives should have on the decision whether to grant planning permission for a landfill proposal. Auld LJ with whom both the other judges agreed, described the objectives in the Directives as having "the status of important considerations, but not necessarily of overriding weight as against all other considerations in a waste planning permission application". He also approved of the way that the first instance judge Stephen*
> *Richards J (as he then was) had expressed the position:*
>
> > *"What matters is that the objectives should be taken into consideration (or had regard to) as objectives, as ends at which to aim. If a local planning authority understands their status as objectives and takes them into account as such when reaching its decision, then it seems*

[37] *R v Secretary of State for Education and Employment e p Portsmouth Football Club* Ltd [1998] COD 142

[38] In the context of spectrum licence fees specifically, see, for example, the wording of Article 13 of the Authorisation Directive.

to me that the authority can properly be said to have reached the decision 'with' those objectives. The decision does not cease to have been reached with those objectives merely because a large number of other considerations have also been taken into account in reaching the decision and some of those considerations militate against the achievement of the objectives".

[CAT notes that] (emphasis in the original, see [2004] EWCA (Civ) 1508, paragraph [90])

95. OFCOM argued that the objectives set out in article 8 of the Framework Directive are of a different status than the objectives under consideration in Blewett because the CRF establishes a detailed harmonised framework whereas the Waste Directives leave it up to the Member States to take appropriate steps to encourage attainment of those objectives. Whether or not that is the case, if the Dispute Determinations had set out a careful analysis of the relevant objectives and Community requirements and gone on to describe valid countervailing reasons for adopting an inconsistent approach, then the Tribunal might have concluded that this ground of appeal was not well founded. As it is, there is insufficient reasoning in the Disputes Determinations as to which objectives – other than the need for the regulator to be consistent – OFCOM considered. We do not therefore consider that the Blewett case assists OFCOM.

5.73 Ofcom does not identify explicitly any specific purpose or objective of their proposals in the ALF consultation.[39] It does not adopt its principal duty as an objective (and there is no evidence in the ALF consultation that it has 'understood' (in the parlance of the *Blewett* case) furthering the interests of consumers (from section 3 CA03) or 'providing greater regulatory certainty to operators (from sections 2 of the Direction and section 5 WTA06) as objectives. As a practical matter, the implied purpose is 'to give effect to the Direction'. That is not a legitimate or sufficient purpose in law unless Ofcom is able to demonstrate that it is seeking to achieve the wider purposes underpinning the Direction. But the consultation document fails to take proper account of section 2 of the Direction (much less demonstrate how the objectives stipulated in that section are furthered by Ofcom's proposals) and is therefore insufficiently robust.

5.74 Relevant statutory provisions or instruments that ought inform a proper analysis of Ofcom's purpose or objective(s) in general terms are:

5.74.1 Section 3(1) - specifically, the requirement to *promote competition* if that is appropriate to the circumstances of the situation;

5.74.2 Section 3(2), that requires Ofcom to *secure the optimal use of spectrum*;

[39] In paragraph 3.12, Ofcom note the requirements of Article 8 of the Framework Directive (which are transposed as the first and second Community requirement in section 4 CA03). In paragraph 3.20, Ofcom recites its principal duty.

5.74.3 Section 4 – specifically, the first and second Community requirements (to *promote competition* and to *promote the development of the internal market*);

5.75 These general provisions are then conditioned by the operation of section 5(3)(d) WTA06, which requires that Ofcom should act 'with a view to achieving such purposes' as the Direction provides – namely, '*creating greater investment certainty for operators*' and to 'maximise coverage'.

5.76 Accordingly, properly construed Ofcom's primary purpose in respect of the Direction should be '*to create greater investment certainty for operators*' and to 'maximise coverage'. Consistent with section 5 WTA06, Ofcom should act with a view to achieving this purpose-.

5.77 In seeking to give effect to the primary purpose of the Direction it is consistent with the statutory regime if Ofcom act in a manner that would secure three other statutory objectives:

5.77.1 To promote competition;

5.77.2 To secure the optimal use of spectrum; and

5.77.3 To promote the development of the internal market.

5.78 Ofcom ought to view these secondary purposes as subordinate to the primary purpose, by virtue of the principle of statutory construction that if a general rule exists and a subsequent, specific legislative provision is made in relation to a particular case, then 'the general does not derogate from the specific'.

5.79 In the case of promoting competition, that purpose may not be relevant in light of the other provisions of the Direction.

5.80 Each of these objectives may be advanced to a greater or lesser extent by Ofcom's proposals, and, in line with the view of the CAT in *TRD*, it is not sufficient to simply refer to these provisions in general terms. What is required is that Ofcom consider its actions and their consequences – particularly the impact on consumers – in light of those objectives. It is not enough to merely answer the question, 'is the proposed action consistent with the achievement of that objective', without explaining <u>why</u> that is the case and the relevant evidence relied on by Ofcom in reaching that view.

5.81 A credible impact assessment is the logical and, as a matter of proper administration of the CA03, the correct means through which Ofcom would be able to demonstrate that it would realise its objectives. This is consistent with Ofcom's approach previously, including in relation to the other tasks specified in the Direction (the 4G auction and spectrum liberalisation).

5.82 Ofcom states at the outset of its consultation that the document constitutes an impact assessment for the purposes of the Communications Act 2003. It is, with respect, nothing of the sort. By long-standing practice and by virtue of section 7

CA03, Ofcom must conduct a proper impact assessment of its proposals once it has elected to pursue that regulatory path. We examine below how the application of Ofcom's own guidelines and consideration of the facts germane to this case render Ofcom's current 'impact assessment' regrettably not fit for purpose.

Impact assessments

5.83 According to section 7 CA03 Ofcom is under a duty to carry out impact assessments when Ofcom is proposing to do anything for the purposes of, or in connection with the carrying out of their functions and where it appears to them that the proposal is important. Ofcom states at section 2.21 that "this document (especially in Section 4, Section 5, Section 7 and Annex 9) constitutes an impact assessment". It is clear that Ofcom considers the threshold set out in section 7 for undertaking an impact assessment has been met and it has discharged it.

5.84 At paragraph 2.21, Ofcom sets out that:

> *"The analysis presented in this document (especially in Section 4, Section 5, Section 6 and Annex 9) constitutes an impact assessment as defined in section 7 of the Communications Act 2003. 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."*

5.85 Ofcom's inclusion of this boilerplate text is insufficient to meet its obligations under section 7 CA03.

5.86 Ofcom accepts, correctly, that its duty to perform an impact assessment is engaged in relation to any revision of licence fees. This recognises that the ALF proposals are 'important' in the sense defined in section 7(2):

> *(2) A proposal is important for the purposes of this section only if its implementation would be likely to do one or more of the following—*
>
> *(a) to involve a major change in the activities carried on by OFCOM;*
>
> *(b) to have a significant impact on persons carrying on businesses in the markets for any of the services, facilities, apparatus or directories in relation to which OFCOM have functions; or*
>
> *(c) to have a significant impact on the general public in the United Kingdom or in a partof the United Kingdom.*[40]

[40] Vodafone considers that the ALF proposals meet all three of these criteria. In the event that Ofcom advances an argument to the contrary, Vodafone would seek to make submissions on these points, although does not do so now as the issue appears to be common ground.

5.87 An impact assessment is not simply whatever Ofcom asserts. It must be consistent, amongst other things, with the requirements of section 7(3) and 7(4), in that it must be:

> *an assessment of the likely impact of implementing the proposal …*
>
> *[and that assessment] must set out 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.*

5.88 Sections 4 and 5 do not deal at all with the question of the impacts of Ofcom's proposal; they are confined to parts of the technical rationale. Section 6 and Annex 9 deal, obliquely, with questions of impact (for example, in relation to the question of whether to phase in increased ALFs) but do so in a way that is manifestly not consistent with Ofcom's guidelines and in the case of Annex 9, framed entirely as a response to arguments put to Ofcom (which, as an aside, Vodafone considers that Ofcom engages with insufficiently).

5.89 Nowhere in the consultation is there an explanation of how, in Ofcom's opinion, the performance of their general duties is secured or furthered by or in relation to the ALF proposals (as required by section 7(4) CA03). As noted earlier, Ofcom's general duties shape how it should approach the discharge of its duties. In the context of an impact assessment, Ofcom should of course be mindful of its obligation in section 3(3) of the Communications Act to ensure that it acts in accordance with the principle of **best** regulatory practice. To the extent that the consultation document can even be described as an impact assessment, it is in no way compliant with the principle best regulatory practice for the reasons that we consider here.

5.90 The reference to 'best-practice policy-making' may not have been intended to have great weight, but it is instructive. The statement refers to a document called '*Better policy-making: Ofcom's approach to impact assessment*'[41] which sets out Ofcom's approach to impact assessments (Ofcom's IA approach). Ofcom states that in developing its approach to impact assessments it has had regard to the Cabinet Office publication, "Better Policy Making: a Guide to Regulatory Impact Assessment" (January 2003).

5.91 This document has since been updated and in July 2013, BIS issued the '*Better Regulation Framework Manual: Practical Guidance for UK Officials*' ('Framework Manual'). This consolidated a number of existing forms of guidance, including the Treasury's *Impact Assessment Toolkit* ('IA Toolkit') and *IA Guidance*. It is part of a system designed to support, and to influence, officials dealing with questions of policy, including those preparing impact assessments. In the Ofcom IA approach, Ofcom qualifies the way which it will implement BIS Guidance by stating:

[41] http://stakeholders.ofcom.org.uk/binaries/consultations/ia_guidelines/summary/condoc.pdf

While they set out our general approach to impact Assessments, the wide range of decisions which Ofcom has to make means this approach will be tailored as necessary to fit the type of decision being made.

5.92 However Ofcom goes on to state:

We will also continue to draw on best practice in the UK and elsewhere.

5.93 It is therefore open to Ofcom, acting reasonably and responsibly, to put to one side the work BIS has done and the Guidance that it has developed over the past eight years. Nevertheless Ofcom's own approach must be within reasonable limits having regard to its statutory obligations to be proportionate, transparent, accountable and targeted. Ofcom has set out the approach it will normally take to impact assessments and it has not stated or given any reason to suppose it will divert from that approach in developing the ALF. That is Ofcom will adopt the following:[42]

Producing an Impact Assessment will normally involve six stages:
• defining the issue we need to consider and identifying the citizen or consumer interest (stage 1);
• defining the policy objective (stage 2);
• identifying the options (stage 3);
• identifying the impacts on different types of stakeholders (stage 4);
• identifying any impacts on competition (stage 5);
• assessing the impacts and choosing the best option (stage 6).

5.94 Quite simply, Ofcom's ALF consultation does not undertake these steps.

5.95 Ofcom's approach in the ALF consultation is simply to assert that the discussion it undertakes is an impact assessment. This glib assurance is bald, and is not consistent with a reading of Ofcom's proposals. Most obviously, there is no proper 'assessment' of any 'impacts' in the document, which focuses narrowly on the 'hypothetical value' question and not the impact of significant increases in ALFs on consumers and on others affected by Ofcom's proposals, including spectrum licensees or competition.

5.96 Given that Ofcom has failed to take any of the steps including to identify options or impacts on stakeholders (including consumers) or competition, Ofcom's purported 'impact assessment' in the ALF consultation is not consistent with its Guidelines and in substance does not comply the duty imposed on Ofcom by section 7 CA03.

5.97 We now discuss some of the missing elements of Ofcom's impact assessment, based on the publicly available information. This is only a preliminary set of points in outline, and cannot substitute for the chance to comment on a properly

[42] http://stakeholders.ofcom.org.uk/binaries/consultations/ia_guidelines/summary/condoc.pdf , page 11.

developed impact assessment prepared by Ofcom and subject to the scrutiny of a public consultation.

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;

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.

Consumer harm – price rises and/or a decline in service quality

5.101 The most striking omission in Ofcom's analysis is its failure to consider whether or not its proposals further the interests of consumers (whether as a whole or specific consumer segments). Ofcom is able to exercise regulatory judgment when deriving a value for the 900MHz and setting charges prospectively, but it does not do so in a vacuum. In this case, the failure to give consideration to the potential impact of the proposed new level of spectrum charges upon mobile consumers means that Ofcom cannot safely conclude that its proposed course action in this case will attain its obligations.

5.102 An impact assessment must naturally consider the effect on consumers of Ofcom's proposals is likely to focus on the trade-off between two factors:

5.102.1 any harmful effect of consumers – for example, whether consumers will pay more for mobile services than they do today, or face the consequences of reduced service quality or network coverage; and

5.102.2 any beneficial effects that are identified by Ofcom that are (a) caused by the increase in ALFs and (b) consistent with Ofcom's duties to take into account.

5.103 The harmful effects may be relatively straightforward to measure – the spectrum charges represent a new 'tax' on mobile services provided using 900 and 1800 MHz spectrum that is levied as a result of the Direction. Put another way, a significant increase in the price of an input forces suppliers to decide how this will be recovered. Generally, the supplier will be forced to adopt some commercial response. That commercial response may take the form of an increase in prices of service provision, or reduced investment. Both options, *prima facie*, may have a negative impact on competition, efficiency (in some circumstances) and on consumers.

5.104 It is far from certain that Ofcom's current course of action generates benefits for consumers that outweigh some of the likely adverse effects that we identify in this section. However, this is logically a matter that should be included in any impact assessment.

5.105 Whether retail prices may increase following the imposition of a higher level of spectrum charges is a matter to which Ofcom has not even turned its attention in the consultation document. However, there is plainly a risk that mobile operators might seek to mitigate their new cost exposure in the form of price rises (possibly in combination with other commercial measures such as a reduction in investment or a reduction in the quality of services to customers). The likely extent of such price rises and the different customer groups likely to shoulder the burden of any increases is a matter that requires considerably greater investigation than that undertaken by Ofcom to date.

Harmful impacts on consumers - deterring network investment

5.106 One impact of Ofcom's ALF proposal might be to affect prices but this is not the only impact that Ofcom's impact assessment ought to consider. Another impact is the effect that Ofcom's proposals would have on network investment – an effect that is particularly important given the explicit purpose of the Direction relating to greater investment certainty and maximising coverage (the two of which are inextricably intertwined).

5.107 In the long term, operators may be able to return spectrum and avoid fees. To the extent that this could affect Vodafone's network capability (including coverage and capacity) and to the extent that other network costs are also avoidable, then ALF will influence the level of network investment over the long term. The risk and consequences of such spectrum handback is a matter to which we return later in this section.

5.108 Equally, significantly, Ofcom has made no meaningful attempt to understand whether licensees may, rather than handing back spectrum, respond to a significant increase in the level of spectrum charges through other actions affecting investment in network expansion, upgrades or network quality. The risk

of the occurrence of such potentially damaging effects should be at the heart of any consumer welfare analysis, yet is curiously absent from Ofcom's consultation document.

The risk of a reduction in network investment

5.109 The conventional economic position assumes that operators have no constraints on investment beyond the need for every additional investment to make a profit (or at least be expected to do so).

5.110 In commercial reality, operators face capital constraints. All are funded by large international Groups which will allocate capital and agree budgets in advance for each of the markets in which they operate, without later adjustments for additional ALF fees or other demands. In other words, ALF fees represent a drain on the cashflows from which UK operators fund their operations as a whole.[43]

5.111 In such circumstances (i.e. with capital constraints), any ALF must be accommodated by means of a reduction in returns to shareholders, an increase in revenues earned from customers, or a reduction in expenditure in the operations.

5.112 There are other reasons to believe that an increase in licence fees would be absorbed by reductions in network budgets rather than by reductions in other operating costs. These include:

5.112.1 reductions in marketing or other retail budgets will have an immediate impact on market share, whereas under-investment (relative to the counterfactual) in network coverage is less visible to consumers and so has a less immediate adverse effect on market share. Put another way, mobile operators have already developed a basic level of coverage to be a credible national network operator; and

5.112.2 reducing investment in network coverage has a much longer lead time than changes in subsidy policy or other marketing expenditure. Operators will seek to remain flexible on the latter, but have to make commitments on the former since network roll out has to be programmed a year or more in advance. Operators will therefore seek to preserve flexibility to respond to competitive pressures via subsidies and other flexible instruments, and sacrifice less flexible options such as investment in network coverage to do so

5.113 In Vodafone's case, our confidential Annex 10 reveals that we will need to take steps to accommodate the increased costs presented by a significant increase in the level of spectrum charges. Such measures may take the form of reductions

[43] We make these points in the general case, as they reflect our understanding, but they are based on the direct experience of Vodafone UK. We do not have visibility of the internal arrangements that our competitors put in place to manage capital expenditure but have no reason to believe that they are materially different to ours.

in network investment and technology upgrades in the network that may go to the quality of existing coverage or capacity. Any deferral of investment could thus affect different groups of consumers in different ways.

5.114 For instance, were Vodafone to defer technology upgrades to its existing [CONFIDENTIAL] 2G only sites (which broadcast the 900MHz spectrum band) to enable the deployment of 3G and 4G technologies through the implementation of SRAN technology at those sites in its network, customers served by those sites on a day-to-day basis would potentially be disproportionately affected as against other groups of customers. These customers are likely to be in rural locations where the economics of network investment is already poor and thus likely not to benefit from the diffusion of the next generation services. Certainly, such an outcome would not be compatible with the one that is sought by the Direction relating to the early deployment of next generation mobile services. Equally, reductions in network investment could affect all customers if they were applied on a network-wide national basis. Put simply, if the impact of a significant increase in the level of spectrum charges results in delay to the emergence of new technologies or improvements to existing technologies that might otherwise occurred had spectrum charges been set an alternative level, the proposed level of spectrum charges could not be deemed to operate in the interests of consumers.

5.115 The consultation is conspicuous for the absence of an enquiry on the part of Ofcom of its stakeholders as to the potential effect of its significant increase in spectrum charges upon the incentive and ability of mobile operators to commit investment to network expansion following the introduction of a significant increase in spectrum charges. To the extent that there is a risk that the level of fees would cause these operators to scale back on the speed of network expansion or improvements to the depth of coverage that would have occurred in a counterfactual with lower spectrum charges, that is plainly a loss in consumer welfare that cannot be deemed to be compatible with Ofcom's duties under the Direction or the wider regulatory regime. This is precisely why a credible impact assessment would seek to assess the form any reductions investment might take and which consumer groups might be most adversely affected by such reductions.

5.116 In this context, Ofcom should be mindful of the evidence of a significant multiplier effect from network investment in broadband, which means that delays to such investment will result in serious consumer harm. A recent study for the Department of Culture, Media and Sport found that improved availability and take up of faster broadband speeds would add £17 billion to the UK's Gross Value Added including £20 of net economic impact for each £1 of public subsidy. Whilst this study was focused upon fixed broadband, it found that the greatest benefit came from increasing broadband speeds in rural areas where mobile networks have an important role to play.[44] Other studies, such as that by Capital

44 https://ww.gov.uk/government/uploads/system/uploads/attachment_data/file/257006/UK_Broadband.Impact-Study_-Impact_Report_-_Nov_2013_-_Final.pdf

Economics, have estimated that the deployment of 4G services across the UK could boost GDP by 0.5%. Ofcom itself noted last year that "*The value of the benefits which 4G services will provide to UK consumers over the next 10 years is likely to be at least £20 billion.*"[45] These wider benefits are precisely the type of issue that should form part of an impact assessment, yet there is no evidence that Ofcom has considered how its approach to setting spectrum charges may affect the realisation of such benefits.

5.117 Unless Ofcom has clear and compelling evidence to suggest that this line of enquiry should not be pursued, it is incumbent upon Ofcom to consider whether, and to what extent, increased ALFs might affect network investment and coverage, even in the short term, and how this might affect consumers.

Harm to consumers – the impact of Ofcom's refusal to consider a transition period for the introduction of new spectrum charges[46]

5.118 One area where it might be expected that the need for an impact assessment is particularly acute is in relation to the question of whether to increase ALFs abruptly, or whether to phase in any increase over time. Like other input costs of supplying mobile services, ALFs are ultimately funded by consumers. Therefore, significant increases in ALFs (of the kind contemplated by Ofcom) will, all other things being equal, cause customers to be worse off in some way. There is a clear risk that any decision on the part of Ofcom to rule out any form of phasing in period for the introduction of new charges will merely exacerbate that risk of an adverse effect on the position of mobile consumers since it increases the pressure upon licensees to mitigate their new and unforeseen significant new cost exposure. Again, there is no evidence that Ofcom has considered in any meaningful way this matter as part of its assessment.

5.119 Ofcom's reasons for its proposed approach are that:

- *the licensees will have been well aware of the impending increase in ALF for more than three years by the time revised ALF fees are implemented (i.e. since the December 2010 Direction). They should also have been able to make well informed estimates of the broad scale of increase that will take place, given the requirement in the Direction for Ofcom to have particular regard to the sums bid in the 4G Auction. 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;*

- *the level of the bids made by the licensees for 800 MHz and 2.6 GHz licences provides a point of comparison for the level of increase in ALF proposed in this document. We note that licensees made bids for the*

[45] http://media.ofcom.org.uk/2013/02/20/ofcom-announces-winners-of-the-4g-mobile-auction/

[46] The comments here are without prejudice to the fact we consider there is no proper evidential basis for Ofcom to determine that there should be any change to the ALF at all. Equally, it is possible that any risk of consumer harm that would otherwise result from an increase in spectrum charges may be exacerbated through

spectrum packages that they won that exceeded the prices they paid by between 80% and 160%. In other words, the licensees made bids which they knew could have required them to make a significantly higher up-front payment than they actually had to make for the spectrum they won in the 4G Auction. The size of their additional financial exposure, which they knew they could have had to absorb in their business plans, significantly exceeds the size of proposed increases in first-year ALF payments that they now face.[47]

5.120 Before even addressing Ofcom's claims, it is first necessary to recognise the scale of Ofcom's proposed increase in the level of spectrum charges. On any objective analysis, an increase in Vodafone's annual spectrum charges from £15.6 million to £85.5 million represents a very significant new cost exposure. Where such an increase could not have anticipated by those subject to the new charge, the risk of adverse consequences resulting from such an increase must be high.

5.121 Ofcom's first statement, premised on the idea that transitional issues can be ignored because it believes that operators had foreknowledge of the likely outcome of Ofcom's future approach to setting spectrum charges, is simply wrong as a matter of fact. Until Ofcom's full proposals became available, no operator has been in a position to assess the likely effect of the Direction on ALFs. Ofcom's statement that operators 'will have been well aware' of the impending increase (much less anticipated the auction outcome, the application of the precise methodology to such outcomes and thus even a range of possible spectrum charges post-auction) contradict the explicit statements to the contrary made in the context of the Competition Assessment, where Ofcom was at pains to emphasise that it was making no commitments, nor could it do so, in relation to its future decisions on the ALF. What Ofcom said in July 2012 was the following:

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. … We … 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…[48]

5.122 To suggest that the operators ought to have been 'on notice' on the basis of a prediction about future decisions that Ofcom could not lawfully have given, and

[47] ALF consultation, paragraph 6.19.
[48] 2nd Competition Assessment and Statement, paragraphs 12.13 to 12.14.

did not as a matter of fact give (in its earlier statements), is simply not credible and a clear error of law.

5.123 The true position is that no operator, properly advised, could have taken steps anticipating the extent of a future ALF increase (for example, raising prices), without knowing the auction outcomes, seeing Ofcom's detailed proposals and how the application of its methodology to the auction data would have generated even a range of potential new spectrum charges. In mobile markets, competition (well-documented by Ofcom) constrains the ability of operators to recover any further costs without sacrificing market share. It would therefore be irrational for any individual operator to act in the way that Ofcom are suggesting operators should have acted, and Vodafone has not done so.

5.124 Ofcom's second statement seems to be that, in essence, higher ALFs are within the limits that the market will bear. But even if this is true, it misses the point, which is this: would a sudden change harm the interests of consumers, compared to a more gradual introduction of a change? The question under consideration in this paragraph is not whether the ALF increases might be something that the market can absorb, eventually: it is whether those price increases should be sudden or gradual. It is necessary to consider this question as it goes to the heart of legal and regulatory certainty that will affect planning and investment decisions.

5.125 When Ofcom adopts a glide-path, as it does in other contexts, it does so not because the amounts at stake exceed some notional limit on the ability or willingness of some market participant to pay more, but because the disruptive effects of a sudden change can harm consumers and competition. Ofcom's policy in favour of glide paths is firmly grounded in deep experience and reflects Ofcom's duties in light of their understanding of the dynamics of price shocks in competitive markets. For example, in the recently published charge control proposals for fixed access, Ofcom explained its position in the following terms:

> *3.143 The glide path approach approximates more closely than one-off adjustments the workings of a competitive market in which excess profits tend to be gradually eroded as rivals improve their own efficiency.* ***It avoids discontinuities in prices over time and leads to a more stable and predictable background against which investment and other decisions may be taken, by both suppliers and customers, in the telecoms market.***
>
> *3.144 The main benefit of this approach is that it has greater incentives for efficiency improvement as it allows the firm to retain the benefits of cost reductions made under a previous charge control for longer. One-off adjustments to prices would reduce the effective regulatory lag, and hence the incentives to reduce costs.*
>
> *3.145 Whilst the above discussions relate to one-off cuts to prices, one-off increases would similarly raise concerns about incentives for efficiency. […]*

3.146 While the above suggests a general preference for the glide path approach in the context of price cap regulation, this does not mean we should rule out one-off adjustments in prices where there are good reasons to introduce them. ***We might make one-off changes if there are strong allocative efficiency or competition arguments for bringing prices into line with cost before the end of the control period. However, in assessing possible one-off adjustments, we would need to balance this against alternative (and potentially more proportionate) regulatory approaches****.*[49]

5.126 Obviously, there may be some differences between price regulation of entities with Significant Market Power under the CRF and the adjustment of ALFs under the spectrum framework. However, in the case of price controls, operators are in fact much more likely to have an understanding of the potential direction of travel or range within which a new price control might fall. This is because the cost model, inputs and methodology for computing price controls are typically well-established and known to operators who are then able to obtain some insight into the level of a new price control. This is not possible in the case of spectrum charges for the reasons already explained. Yet, in the case of price controls, where more information is known to stakeholders, Ofcom still enables operators subject to the price control to benefit from a transition period. Any decision by Ofcom to decline to provide operators subject to new spectrum charges with any transition period would be inexplicable and inconsistent with established regulatory practice.

5.127 Equally, the arguments about the need to avoid market disruption emphasised in the extract above do apply equally to ALFs. In both cases:

5.127.1 Ofcom is setting by regulation an amount which will be paid by one class of competitor from amongst a group of competitors;

5.127.2 Ofcom's decision will affect the rate of change in that market, potentially affecting consumers and other parameters such as investment that falls within the scope of Ofcom's relevant duties;[50]

5.127.3 Ofcom is seeking to do as little damage as possible to the competitive dynamic in and evolution of that market, whilst performing its duties.

5.128 In the ALF proposal, contrary to the position taken in other proceedings, Ofcom has not even provided any evidence to analyse the potential impact of any price shock on consumers or operators.[51] Consequently, Ofcom is simply not in a position where it could conclude that a decision to allow a sudden introduction of increased ALFs (with no transitional arrangements) will have no harmful effects.

[49] WLR/LLU Charge Control Consultation, July 2013 at paragraphs 3.143 to 3.146. Emphasis added.
[50] For example, by virtue of section 3(4)(d) CA03.
[51] See by comparison the discussion of the impact on consumers in the Ofcom 2011 MCT Statement at paragraphs 10.28-10.41 (the comparison is for scale and scope of such an analysis as opposed to the precise content. Although the glidepath was reduced by a year, it was not eliminated).

5.129 Similarly, there is no analysis that would suggest that Ofcom has concluded that there are 'strong allocative efficiency or competition arguments' for rapid changes in ALF. Ofcom does not provide any objective justification for an abrupt change – and nor does it situate Ofcom's proposals in the context of Ofcom's long-standing and well-established practice of avoiding sudden price shocks where it can. Ofcom's approach therefore cannot be considered to be proportionate or targeted.

5.130 Ofcom has failed to take any account at all of how operators may deal with a price shock. It would not have required a disproportionate effort to make further enquiries amongst its stakeholders, consider the potential impacts on consumers and operators and attempt to measure them.

5.131 This reasoning suggests that an increase in the ALF paid by 900MHz and 1800MHz spectrum licensees is likely to be recovered from those operators' customers – and from amongst those customers, the rational strategy is to recover those costs as far as the operators plausibly can, from the services that use that licensed spectrum. As noted earlier, Ofcom must consider the extent to which additional unforeseen costs might be mitigated through the increase in retail prices and which customer groups might be disproportionately affected. Once again, this is a highly relevant consideration in seeking to determine the impact of a failure to phase in any new charges.

5.132 Ofcom may have considered how consumers may have been made worse off by the sudden and unexpected significant increase in the level of spectrum charges through reduced investment in the network or handback of spectrum. There is a clear risk that a significant increase in the level of fees that could not have been anticipated by mobile operators will add further costs pressures that may well lead to reductions in expenditure allocated to network expansion and upgrade programmes. The impact of such reductions may be felt by all customers or more disproportionately by certain consumer segments. Once again, the deferral or cancellation of such programmes that would otherwise have been launched must be considered in greater depth to enable Ofcom to form a view as to the level at which spectrum charges are unlikely to generate such an outcome.

5.133 Consistent with the approach taken in other regulatory proceedings involving the impact of possible cost shocks, Ofcom ought to consider the effects of these changes on consumers in general and on specific groups of consumers (which may also be part of its equality impact assessment). For example, in its last review of mobile call termination, Ofcom considered the effects of price changes on consumers in general, but also on consumers who were socio-economically disadvantaged and those who were mobile-only (since the risk of losing their mobile service was more significant to consumers who did not have ready access to a fixed-line alternative service).

5.134 In other proceedings where it was required to decide how and when to implement a change in regulation, Ofcom has often exhibited a laudable sophistication and depth of analysis in seeking to understand the impact of a

proposed course of action upon consumers, including on vulnerable groups. It is not clear why Ofcom has so radically departed from this course in the ALF consultation. In this regard, it is difficult to see how Ofcom is acting in the course of this consultation in accordance with its duty to undertake its role in a consistent way that enhances legal and regulatory certainty.

5.135 Whatever the reason, Ofcom's duties require that any decision about phasing-in of ALFs should be based on an assessment of the impacts in light of Ofcom's duties – most notably the impact on consumers. Certainly, there is nothing on the face of the Direction that would inhibit Ofcom from adopting such a course of action that would require Ofcom to impose any spectrum charges with immediate effect; indeed, were the lack of a transitional period to increase materially the risk of immediate reductions in investment, that outcome would be incompatible with the Direction.

Mechanics for recovery of spectrum charges – consequences for investment certainty

5.136 A second issue, relevant to the question of how to manage the transition to a different ALF, is the question of how to ensure that the transition is appropriately managed in a way that that ensures that charges apply on a genuinely forward looking basis. The existing licence fee arrangements are set out in The Wireless Telegraphy (Licence Charges) Regulations 2011.[52]

5.137 Those Regulations provide that licensees must pay licence fees "*on the issue of the licence*" and "*on the last day of the period…for which the licence continues into force*".[53] This implies that the payments for licence fees are paid in arrears.[54]

5.138 In the ALF consultation Ofcom is proposing to bring the commencement dates of the various operators into line with a common effective date ("CED") which will be "*the first day of the month following the month in which the new fees regulations come into force*". The method Ofcom intends to apply to achieve this by is to adjust the size of the fee payment in the first year by:

> *The amount of the first payment following the common effective date would be made up of two sums:*
>
> *• the revised ALF applied to the licensee's spectrum holdings; plus*
> *• a sum equal to the difference between the revised ALF and current ALF, pro-rated in relation to the number of months between the common effective date for the introduction of the revised ALF and the licensee's payment date.*

[52] http://www.legislation.gov.uk/uksi/2011/1128/pdfs/uksi_20111128_en.pdf. As amended in 2012 and 2013.
[53] Section 4(1)
[54] This implies that licensees will be required to make one payment more than the term of the licence. For example, if it is a 12 year licence, the licensee will make a payment on commencement, followed by 11 payments on the anniversary of the commencement date and a payment on the last day of the licence – 13 payments. There is no, as far as Vodafone is aware, no particular policy justification for this approach.

5.139 This creates a problem in that the payment that 'adjusts' the ALF is likely to result in an 'underpayment' in the penultimate period (prior to the switch) and an 'overpayment' in the following year. But such an 'overpayment' (in effect, requiring an operator to pay in respect of the same licence twice with respect to one payment period) is not consistent with Ofcom's duties – and is unlikely to be conducive to creating an environment that stimulates investment - not least of which, because on Ofcom's own logic, for that year, an operator overpaying will be paying an ALF that is more than the level that is equivalent to 'full market value'.

5.140 In the event that Ofcom continues to propose an increase in Vodafone's ALFs, then Vodafone would expect that Ofcom will propose an amended transitional regime to avoid any 'overpayment' periods. One obvious solution is to reduce the price paid in the transition year so that the initial element is not the revised ALF, but the previous ALF.

5.141 This would also be more consistent with the Direction, and in particular the need to provide operators with 'greater investment certainty'. Current licence fees are known, and have been able to be accounted for in the business plans of the operators. Maintaining that known level of licence fee for a longer period than otherwise provides greater regulatory certainty than an earlier cut-over to a new, higher (and as yet unknown and hence, uncertain) licence fee. In this scenario, the provisions of the Direction relating to market value must be read in a way that is consistent with the objectives of the Direction and the regulatory regime. Ensuring that spectrum charges 'reflect' market value provide an element of flexibility to the regulator when considering how to set charges and equally importantly do not obviate the need for the regulator to consider whether the way in which charges are imposed would undermine the realisation of the Direction's purposes.

Promoting and encouraging investment – asymmetry of risk

5.142 The final significant omission in Ofcom's analysis is in relation to 'greater regulatory certainty'. Sections 4 – 5 and Annexes 6 – 8 of the ALF consultation have a narrow focus on determining what, in Ofcom's view, is the hypothetical market value for 800 MHz and 900 MHz licences. That is to say, in these sections Ofcom has not attempted to consider the impact that setting the ALF at a particular view of market value will have on its wider regulatory objectives and statutory duties.

5.143 In Annex 9 Ofcom sets out its analysis to address the narrowly put question "*Whether there is an asymmetric risk of inefficient use of spectrum from setting ALFs too high or too low*". Ofcom states that this section is responsive to arguments put to it by licence holders.[55] Ofcom addresses a number of issues

[55] However it is difficult to imagine a licence holder arguing for a licence fee higher than market value.

that relate to the impact on investment decisions of licence holders as a result of setting the licence too high or too low and in summary Ofcom concludes:

> *…it is not appropriate to set ALFs either below or above the levels implied by our best estimates of market value for reasons of spectrum efficiency…*[56]

5.144 The issue at hand is not whether Ofcom should identify a value for the 900MHz band and then factor in a discount. Given that there is no directly available recent evidence about the value of the 900MHz band, what Ofcom must do, through its approach, is identify a range of values that could be attributed to the 900MHz band and identify the value that is most apt to secure the objectives of the Direction (and by implication its Community law objectives). Part of that analysis must assess whether the value proposed in a range would be likely to create a risk of handback of spectrum by the licensee and the effect on mobile consumers of such handback.

5.145 However, this is not what Ofcom has done in this case. Ofcom has heavily weighted its estimate of value of ALF to the operators on the basis of their sealed 4G auction bids, i.e., the price that the operators were willing to pay for the 4G licences, when estimating whether there would be any investment or efficiency impacts from setting an ALF too high. Ofcom concludes that given that the winning bidders were willing to bid between 80 – 160% more than they paid for the 4G licence then there is no asymmetric risk of valuing licences too high as long as the ALF is within this range.[57]

5.146 Ofcom has assumed far too much from the 4G auction bids without recognising the limitations on the use of such data. There are many financial and strategic reasons for the final figures put in the 4G auction bids. The auction conditions were not those of an open market, but of a regulatory construct, designed by Ofcom to achieve a certain market structure. Most significantly of all, Ofcom has been unable to explain to stakeholders its rationale for the assumption that the relationship between private and market value for spectrum for large blocks of 800MHz spectrum being sold in an auction process can be used to determine the value of the marginal much smaller tranche of 900MHz spectrum.

5.147 Ofcom recognises that there is a potential risk posed as identified by Frontier Economics in setting ALF in relation to the expropriation of the value of the sunk cost incurred by operators investing in their networks. However, Ofcom explains that there is no need for concern because, essentially it is an equal bet; that is, there could also be a windfall gain.[58] Ofcom makes no attempt to quantify how a windfall gain could be considered an equal bet given the potential harm of expropriation to operators and consumers, and indeed, government. Ofcom further states:

[56] ALF Consultation Document, Annex 9.4.
[57] ALF Consultation Annex 9.36.
[58] A9.41

We note that the potential for ALF to become out of line with market value is but one of many uncertainties that the operators face in their business. It is not clear that there should be a significant risk premium arising from this particular source of uncertainty.

5.148 As well as being a relatively superficial analysis, this statement fails to engage with Ofcom's relevant duties in relation to investment and, most specifically, the requirement to act in a way that 'increases regulatory certainty for operators' (discussed further below).

5.149 Ofcom further argues:

We also note that in most cases the licences concerned have been held for a number of years, and that licence holders have paid fees which are substantially below those we are currently proposing.

5.150 This is an irrelevant consideration in the context of setting ALF on a basis that reflects market value (as that value stands today), taking into account the various risk factors faced by the operators when first taking out licences compared to what they *now* face.

5.151 Ofcom also rules out the risk that the proposed value of 900MHz spectrum and resulting charges may be likely to result in a handback of spectrum on the basis that there may be an alternative user of the spectrum that would emerge to mitigate any harm to consumer welfare. This might be true theoretically, but applying the principle of double proportionality (described at section 3) requires Ofcom to undertake a considerably more robust analysis and investigation than the one it has undertaken to date. Vodafone has identified no evidence that Ofcom has sought to assess whether an alternative use of the 900MHz band is viable or even if a new user or completely new entrant in the mobile communications sector wishing to provide a national network (with all the high sunk costs entailed with that commercial objective) is likely. It is simply not in a position to reach any safe conclusions about the risk of handback of spectrum being mitigated.

5.152 Any assessment of the handback of spectrum must therefore seek to determine the likely loss suffered by mobile consumers. The quality of services (notably 2G services) provided by a mobile operator previously holding 900MHz spectrum would be adversely affected and even if a new entrant were likely to emerge, past experience from the divestment and sale of spectrum by Everything Everywhere in the context of its merger suggests that it would be some years before the spectrum might be cleared and available for exploitation by another operator. These are all considerations that should be part of a welfare analysis. Yet, there is no meaningful analysis of such issues in Ofcom's consultation document.

Promoting greater investment certainty – duration of ALF

5.153 Although Ofcom's analysis does not refer to it at all, section 2 of the Direction (in the context of section 5 WTA06) makes it clear that *regulatory certainty* should play a significant role in Ofcom's thinking. Specifically, any ALF proposals should be created 'with a view to' securing not just a degree of regulatory certainty but *greater* certainty for operators. In practical terms, that expression means that any new spectrum charges must improve upon the regulatory environment that exists today.

5.154 In order for Ofcom to perform that duty, it is necessary to start by asking itself: what affects regulatory certainty? And what actions can Ofcom take (or not take) to increase regulatory certainty for operators?

5.155 We understand regulatory certainty to be defined relative to its antonym: *regulatory risk*. Operators have greater regulatory certainty when the extent to which they are exposed to regulatory risk is reduced – that is, the risk that assets or value will be appropriated through a decision to change the regulatory rules (or impose new rules), particularly when there is a risk that such rules may change at will and in circumstances that are unknown to the industry stakeholder. Sometimes regulatory risk can arise from the decision to change the formal statement of a rule, but it can also include, for example, a decision to take a different approach in relation to the enforcement or interpretation of an existing rule.

5.156 In the context of seeking to achieve a regulatory framework that creates conditions that facilitate investment on the part of mobile operators, Ofcom has neglected to consider the potential benefits of setting spectrum charges over the longest possible timeframe. Plainly the risk of periodic reviews of spectrum charges - the timing of which would not be known to licensees - to determine whether the value of spectrum had altered would be unlikely to enable licensees to take decisions about the level of investment with confidence. In this regard, Ofcom's proposed approach to assess potential changes to the value of the spectrum in question is deeply unsatisfactory. It proposes that it might review spectrum charges where:

5.156.1 There is 'clear evidence' that the value had changed suggesting that the level of spectrum charges is no longer appropriate; and

5.156.2 Ofcom is able to generate a more reliable estimate.

5.157 Neither of these thresholds is attractive to stakeholders since they are incapable of engendering any level of legal certainty on the part of licensees when taking commercial decisions. The trigger for establishing what constitutes 'clear evidence' is not specified anywhere and certainly not capable of being relied upon by any licensee on a long term basis, whilst the suggestion that Ofcom should determine what constitutes a reliable estimate would enable it to operate in an arbitrary and unfettered way. Put simply, licensees would be the invidious position of seeking to determine which particular events might cause Ofcom to

re-assess market value and then second-guessing whether Ofcom may have alighted upon an alternative indicator of market value. Regular or ad hoc reviews of the value of spectrum based on imprecise and ambiguous criteria are highly unlikely to create an environment that facilitates sustained investment to the benefit of consumers. Ofcom has given no serious consideration as to how its proposal would promote certainty for investment and in fact whether it would be more likely to have deleterious consequences on the future behaviour of licensees.

5.158 The most prudent way forward would appear to be to set spectrum charges over a longer timeframe so that licensees can obtain the necessary legal and regulatory certainty.

5.159 However, if Ofcom does set charges over a longer period, Ofcom will necessarily need to reflect the fact that market value is not static and will need to take into account now changes in circumstances over any designated timeframe. In this regard, the Direction would not preclude such an approach since it does no more than invite Ofcom to revise spectrum charges in a way that 'reflects' market value. The term 'market value' itself is nowhere defined in the Direction, and as noted earlier, could not be fixed in time and perpetually anchored to auction data generated in February 2013. In fact, the term is sufficiently broad to provide Ofcom with the ability to take into account any developments of which it is aware will arise – such as the release of additional spectrum bands for exploitation by mobile operators – and factor those developments into valuation of spectrum prospectively. Most importantly of all, and as noted previously, Ofcom must be satisfied that any view of market value must be capable of delivering the enhanced legal certainty that facilitates investment and the expansion of coverage, both of which are contemplated by the Direction.

Securing the optimal use of spectrum

5.160 Ofcom is required, as one element of its principal duty, to secure the optimal use of spectrum.

5.161 Ofcom states that it considers that its proposals are 'consistent' with that duty.

5.162 Mere affirmation that a particular approach discharges an obligation is not adequate to enable Ofcom to satisfy itself that it has discharged its principal duty in relation to securing the optimal use of spectrum.

5.163 This issue is central to the exercise of Ofcom's radio spectrum functions, and we draw Ofcom's attention to the work done by Frontier Economics in relation to the asymmetry of risk and the risk of consumer harm resulting from inefficient spectrum use if spectrum is handed back and subsequently lies fallow.

5.164 We will reserve further comment on this issue until we are in a position on some meaningful statement from Ofcom as to how it places its proposals in the context of its statutory duty.

6. Ofcom's failure to address meaningfully alternatives to auction values when setting spectrum charges

6.1 As the Frontier Economics analysis reveals at Annexures 2-5, the UK auction data and the international benchmarks do contain a number of limitations and are evidently – as Ofcom's analysis demonstrates - susceptible to a high risk of analytical error. Provided that any analytical framework is adapted to accommodate and adjust for a number of limitations, this data can provide a useful starting point for determining the value of the 900MHz and 1800MHz bands.

6.2 However, even the adjusted UK auction data and international benchmarks do not provide the sole source of insight into the value of the 900MHz and 1800MHz bands. It would therefore be logical and reasonable for a responsible regulator to contemplate the use of alternative methodologies to validate any view of market value being derived from the auction data and international benchmarks (some of which could not reflect recent technological developments). To the extent that technical cost modelling generates a wider or different set of values from those derived from the analysis of the auction and the benchmarks, a wider range of values can only be helpful in assisting Ofcom to understand the impact of increases in spectrum charges and thus determine the value at which it is most likely to achieve its legal duties when managing radio spectrum. Cost modelling leaves open the scope for sensitivity analysis, another important way of validating that any value attributed to the 900MHz spectrum band is robust. The need for this type of analysis is all the more compelling given that Ofcom is not in possession of direct evidence about the value of the 900MHz band; in such circumstances, a decision not to apply another recognised methodology that might enable Ofcom to proceed safely seems particularly rash.

6.3 In this particular instance, the most obvious alternative candidate methodology would be technical cost modelling that Ofcom has previously used as part of its opportunity cost approach to setting spectrum charges for the spectrum bands in question and a number of other spectrum bands more recently. Given the scale of the proposed increase in spectrum charges (representing a transfer of value out of the industry of £300 million), the double proportionality requirement articulated in section 3 of this submission requires Ofcom to be commensurately more rigorous. That level of rigour would necessarily include the use of technical cost modelling to validate values derived from the auction. As Vodafone's separate submission on cost modelling approaches at Annex 9 reveals, it is far from being a burdensome task for Ofcom to construct such a model, not least given that it has done so on a number of occasions when setting spectrum charges. Annex 9 of our submission demonstrates the core assumptions and inputs that would be needed to undertake this modelling exercise. Thus, there can be no suggestion that undertaking such an exercise is disproportionate.

6.4 But Ofcom has ruled out, in this case, the use of cost modelling as a means of stress testing the analysis of the auction data. We therefore consider in this section the credibility of Ofcom's reasoning for ruling out the use of such cost modelling and explain why it is particularly necessary for Ofcom in the context of constructing a new, credible impact assessment that sets out a range of options and drawing on a wider and more robust pool of evidence (which may well be generated by cost modelling).

Cost modelling

6.5 Ofcom falls into an error in law in elevating auction values (domestic and international) over cost modelling. The result of this error – at its root, a failure to take into account a relevant source of evidence – is that Ofcom's process risks falling into an 'echo chamber' of benchmarking. Spectrum is not an asset that is routinely bought and sold in a secondary market, where some players are not concerned with the end-use of the asset, merely what it will fetch when sold on. It can be neither imported, nor exported given that spectrum regimes are national in scope. The use of UK auction data and international benchmarks contains risks for the purposes of deriving market value and is subject to a wide margin of error; the Frontier Economics analysis demonstrates this to be the case, revealing a number of basic errors of fact or assessment that Ofcom has already made.

6.6 Given the uncertainties associated with assessing a hypothetical, forward-looking value of spectrum, it is particularly disappointing that Ofcom choose to narrow their pool of evidence by ruling out using technical cost modelling to calculate market value. The ALF consultation notes that:

> *4.10 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.*
>
> *4.11 We have not undertaken new technical or cost modelling specifically for the purpose of deriving ALFs. This is consistent with our view in the July 2012 Statement (see Annex 6 for a further discussion). While there is some uncertainty in interpreting international and UK auction prices, the range of evidence has enabled us to take a balanced view of the market value of spectrum in the 900 MHz and 1800 MHz bands. Market values derived from technical and commercial cost modelling are highly sensitive to the range of assumptions that need to be made, such that we consider that an attempt to derive point estimates of value based on this approach would be of limited additional benefit.*

6.7 At Annex 6, Ofcom then provides a list of objections that cause it to reject the use of cost modelling in this case (complexity of modelling, sensitivity of estimates to assumptions and the inability of modelling to capture intrinsic value of spectrum). We find these reasons to be wholly unconvincing as we discuss further below and in more detail at Annex 9 to this submission.

6.8 Vodafone disagrees with Ofcom's characterisation of technical cost modelling as incapable of being robust. It is an approach that can give meaningful information on spectrum values, and Ofcom itself has an extensive track record of using the method for spectrum fee setting, not only for other spectrum uses (where scarcity has been established), but also for setting charges for use of the very same spectrum bands that are under consideration in this consultation.[59] Certainly the reasoning underpinning Ofcom's provisional conclusion is at odds with Ofcom's own general position that technical modelling can be used to set spectrum fees in conditions of spectrum shortage and to assist in determining optimum use of a particular spectrum band, and deriving reserve values for the recent auction.

6.9 Failing to even consider the construction of a technical cost model is therefore a serious error in Ofcom's approach.

6.10 If technical cost modelling is now deemed to be prone to such a high margin of error or uncertainty (as Ofcom claims in Annex 6), a question must arise as to why it was deemed reliable for other purposes. We set out below and in more detail in Annex 9 the occasions on which Ofcom has deployed such an approach. There is no suggestion in any of these cases that Ofcom considers technical cost modelling to be too complex or unreliable.

6.11 Vodafone attaches with this submission a separate paper on cost modelling and its likely impact on any ALF proposal. The most important points are:

6.11.1 There is widespread use of technical cost modelling, both by Ofcom and by others and the technique as a strong track record in assisting regulators in resolving questions of spectrum value;

6.11.2 Ofcom has previously made clear that AIP driven by technical cost modelling is Ofcom's preferred method for valuing spectrum and setting spectrum fees in conditions of spectrum scarcity;

6.11.3 Ofcom's criticisms of the effectiveness of modelling in this consultation are incorrect and misdirected – Ofcom is using the obvious known (but not insurmountable) difficulty of *coverage* modelling as a reason not to embark on the currently required *capacity* modelling approach (that was used by Ofcom AIP in 2004 and by Analysys Mason DTT in 2013). But Ofcom used coverage based modelling to assist with setting the reserve prices in the auction in 2012;

[59] See Annex 9, section 1 for details of the instances in which Ofcom has used technical cost modelling.

6.11.4 As a result, Ofcom fails to examine of the principles of the design of an appropriate model to give a view on the value of 900/1800 spectrum, and therefore fails to equip itself with an analysis that would enable it to assess the value of cost modelling in the context of ALF;

6.11.5 A more detailed consideration of the DotEcon cost modelling July 2012 used in reserve price setting for the UK auction would provide further evidence as to the value of cost modelling;

6.11.6 There is also scope to use the Analysys Mason DTT alternative use for mobile AIP model, review and critique – although the results may need to be interpreted with care, it can still provide important insights into spectrum value;

6.11.7 In circumstances where Ofcom is not overwhelmed with a plethora of evidence about the 900MHz band, cost modelling provides a way of calibrating spectrum value derived from the auction analysis.

6.12 The question then is why Ofcom finds that it does not need to consider the use of cost-modelling. Ofcom implies at Annex 6.27 that the provisions of the Direction are sufficient to enable it to rely solely upon auction data:

> *"As regards Vodafone's comments about the Analysys Mason Model in the context of spectrum pricing for broadcasting, we note that the Direction requires us, in revising ALF for the 900MHz and 1800MHz bands, to have particular regard to the sums bid for licences in the Auction…In any case of spectrum pricing we would seek to have regard to all relevant evidence."*

6.13 There are two striking flaws in the above statement. The first is that were the final sentence true, Ofcom should logically have considered any outputs generated by technical cost modelling. This is not a particularly burdensome exercise given that Ofcom has applied and relied upon such a methodology in the past. More importantly, Ofcom appears to believe that the provisions of the Direction mean that the auction data should be elevated to assume greater significance over other ways of assessing full market value. That approach, is, as we have explained, wrong in law. The Direction invites Ofcom to consider the relevance of the data generated by the auction as <u>one</u> data point, but it does not and could not require that Ofcom rule out the possibility of using alternative methodologies (even if only to validate the use of any value derived from the auction data). The simple reason why such a requirement would be unlawful would be that it would represent impermissible interference in the discharge of the regulator's functions, such that it would potentially be unable to satisfy itself that the purposes of the Direction and the wider regulatory regime had been achieved.

6.14 Ofcom goes on to argue that the technical modelling that is already within its possession is not capable of being used for drawing inferences about the relative value of 900MHz and 800MHz spectrum. Ofcom may well form a view that

information gleaned and deployed in an entirely separate regulatory context *may* not be appropriate for the purpose of establishing relative value of different spectrum bands. But, if anything, that is all the more reason for it to undertake the technical modelling exercise now to generate a reliable value. As noted at the outset of this section, Ofcom's approach to the use of an alternative methodology must be described as cavalier and unlikely to be compatible with the standard of proof upon it in a case involving a significant change to the cost structure of the mobile communications sector. The only way forward in these circumstances is the construction of a cost model and then for that model and the assumptions underpinning it to be subject to industry scrutiny as part of a revised Impact Assessment.

Consulting on a range of outcomes provides stakeholders with transparency over Ofcom's reasoning

6.15 It is also appropriate, in the face of that uncertainty, to lay out Ofcom's reasoning in a transparent way. Indeed, it is only through the use of a range of values that an Impact Assessment can seek to demonstrate to stakeholders the potential effects of setting a particular spectrum charge.

6.16 Moreover, developing a range allows respondents, including consumers, to understand what element of quantification arises as a result of the evidence and what element of quantification arises as a result of the exercise of regulatory discretion.

6.17 By presenting a single number in the consultation document, Ofcom therefore fail to disclose the extent to which they exercise judgment, and thereby fail to operate with due transparency.

6.18 Ofcom gives the following explanation for not consulting on a range:

> *We recognise that there is uncertainty about the full market value of these bands and that the process of revising annual licence fees necessarily requires us to use our judgement to estimate the full market value. We have set out in this document our proposed approach for making this estimate, including proposing a figure for each band as our best estimate of full market value, given the available evidence. (2.10)*
>
> *We considered whether it would be helpful as part of this process to have an intermediate step of deriving a range for each band within which we considered it likely that full market value fell, before going on to arrive at our best estimate (i.e. a single figure within the range). However, in light of the nature of the evidence on which we propose to rely, and the spread and distribution of the evidence points for each band, we consider that this intermediate step (deriving a range) would not assist us in arriving at our estimate of full market value. (2.11)*

6.19 Ofcom do not suggest that it would be difficult to explain the range of outcomes from within which they choose their estimate; they are frank in their admission

that there just isn't any advantage *to Ofcom* in doing so. Ofcom's approach starts with Ofcom's assessment that it isn't to Ofcom's advantage to so ('*this intermediate step … would not assist us*'), and does not recognise any wider value in exposing their reasoning to scrutiny. Ofcom's consideration is therefore whether or not it would be 'helpful' to Ofcom's organisational priorities, construed narrowly – but there is no evidence that Ofcom have considered whether it would be helpful to consumers or other stakeholders, or helpful in the context of their duty of transparency.

6.20 It would be helpful *to stakeholders*, and bring greater transparency and consistency, to consult on a range. Vodafone submits that Ofcom ought to do so, and that its failure to properly understand that it ought to do, in light of the exercise of regulatory judgement that Ofcom undertake, represents an error in law. As with other deficiencies in the ALF consultation, the root cause of that error is Ofcom's failure to properly analyse its statutory duties.

6.21 Vodafone finds it very doubtful that Ofcom's own decision-making process did not involve *at any point* the consideration of a range of possible outcomes, and then a process of choosing from amongst them. It might the case, although the deductive process that Ofcom describe in the ALF consultation lends itself to the creation of a range. And given that such a range does exist, the question arises as to the grounds on which Ofcom exclude that thinking from the scrutiny of a public consultation. The answer may be that this is an attempt to reduce the extent to which their logic is open to scrutiny – that is, 'JR-proofing' the proposals. If this has informed Ofcom's thinking, Vodafone urges Ofcom to re-consider its approach, not least because the failure to provide adequate reasoning about its approach is sufficiently material to render the decision unsafe even from the perspective of judicial review.

The role of cost modelling in setting a range of values

6.22 When undertaking its impact assessment Ofcom must therefore reconsider its current approach of relying solely upon the values generated from an analysis of the auction and international benchmarks. Instead, it must consider whether analysis of a wider range is necessary for the purposes of ensuring that it will achieve its wider objectives and duties in managing radio spectrum. In this respect, technical cost modelling may be of considerable value:

6.22.1 In the first instance, the technical cost modelling can, through the use of appropriate assumptions, seek to take into account new facts and circumstances that could not have been reflected in international auctions conducted some years ago;

6.22.2 The technical cost modelling thus is able to serve in the first place as an important validation check upon any values generated by the use of the auction data. To the extent that there is a material difference between the technical cost modelling outputs and those from the auctions, that should cause Ofcom to revisit its analysis

with a view to ensuring that its proposed approach is robust and will in fact attain its duties and obligations;

6.22.3 The use of technical cost modelling may well generate a wider spread of values, potentially lower than those generated by the analysis of the auction. If anything, that wider range enables Ofcom to determine, from the perspective of an impact assessment, whether the value based on the auction and benchmark data is the most apt to secure Ofcom's duties and obligations. If there is a lower value that will secure an outcome that improves consumer welfare (as compared to the value based on the auction data), Ofcom must consider whether it is appropriate to adopt that lower value. That approach would be entirely consistent with its primary and overarching obligation to ensure that any new spectrum charges were proportionate to the wider policy objective.

6.23 More generally, in the context of its impact assessment, Ofcom should assess the effect of a value at the lower end of the range an ALF that is the same as or very close to the level of existing licence fees. Reasons to adopt this as the low end of the range include that:

6.23.1 Understanding the consequences of a 'do nothing' or 'limited change' option ought to be considered unless there is some pressing reason not to do so. This is a necessary part of a conceptual framework and best practice in impact assessment since it provides an important reference point to understand the effect of changes in regulatory approach;

6.23.2 Certainly, there is no requirement in the Direction that the licence fee be increased, merely that it be 'revised'. A revision implies a reconsideration of the licence fee, with no necessary inference that review excludes the possible outcome of establishing that the existing licence fees are already reflective of market value and able to attain the purposes of the Direction and Ofcom's wider duties;

6.23.3 There is no administrative or resource cost associated with including that outcome within the range and then undertaking an assessment.

6.24 If Ofcom is able to adopt the approach proposed above, the prospects of setting spectrum charges that are based on a lawful impact assessment are likely to be materially enhanced.

7. Concluding remarks

7.1 The detailed legal analysis and substantive economic analysis undertaken by Vodafone reveal serious shortcomings in Ofcom's approach to the setting of spectrum charges that pose real risks to consumers and spectrum licensees. Accordingly, any decision to set spectrum charges prospectively based on the approach proposed in the consultation would be legally flawed due to:

7.1.1 Clear and repeated errors of law relating to the interpretation and application of the Direction as well as the wider statutory framework governing Ofcom;

7.1.2 Errors of law in relation to the standard, to which a regulator undertaking a prospective analysis of a matter of significance to the industry that it regulates, must adhere;

7.1.3 Significant errors of procedure and assessment relating to the conduct of an impact assessment resulting from a failure to make relevant enquiries and gather evidence;

7.1.4 Manifest errors of assessment relating to the assessment of auction data.

7.2 Individually and collectively, these errors leave Ofcom with little option but to return to the drawing board, commence its analysis afresh and subject its revised analysis and new Impact Assessment to industry scrutiny. Absent that revised analysis, Ofcom cannot proceed with any degree of comfort that it has attained its legal duties and in so doing promoted the interests of mobile consumers and appropriately respected the rights of spectrum licensees.