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NON-CONFIDENTIAL VERSION

29 August 2007

Dear Joe,

Hutchison 3G UK Limited (“H3G”) response to Ofcom consultation “UK Broadband application for licence variation” (the “Consultation”), published 18 June 2007

H3G believes that there are legal, technical and other reasons why Ofcom should refuse UK Broadband’s application for variations to the terms of its licence. The Consultation considers two potential licence variations (the “variations”): the removal of the limitation to offer fixed applications and the increase in allowable power limits under UK Broadband’s licence. Ofcom’s legal and technical assessment of these variations in the Consultation is incomplete and H3G believes that a full and proper assessment would lead to the conclusion that the variations are not desirable.

Executive summary

Ofcom’s preliminary indication that it is minded to accept the proposed request for the variations to UK Broadband’s licence is flawed and any decision to accept the proposed variations would be unlawful and/or irrational for one or more of the following reasons:

- Ofcom has failed to consider properly the legal factors relevant for assessing the variations, including actual and potential bidders’ legitimate expectations raised by the terms of the 2003 3.5GHz spectrum auction (“2003 Auction”), [●];
- the benefits arising from allowing the variations have not been assessed, given that mobile broadband services are already being provided;
- the Consultation provides no detailed analysis of why the entry of one additional provider of mobile or nomadic broadband will improve welfare (only considering the benefits and not the costs, and not quantifying such benefits); [●]; and
- the variations will not promote efficient spectrum use or benefit consumers.



Consistency with Ofcom's "market based" approach to spectrum management would suggest that, if UK Broadband no longer requires its licence for fixed use, it should not exercise its option to extend the licence term beyond 2008. Under its own current policies, Ofcom should then re-auction the spectrum on different terms.

[•]

Ofcom's legal analysis is flawed

It appears from the Consultation that Ofcom's consideration of the legal basis for allowing the variations, and consequent preliminary conclusion to permit them, provides no proper reasons for departing from previous policy and statements.

Departing from previous policy and legitimate expectations

The Consultation constitutes a departure from previous policy without proper reasons and is likely to breach legitimate expectations [•].

UK Broadband won its licence in the 2003 Auction and paid its licence fee on the understanding that this was limited to the use and power limits explicitly stated in the 2003 Auction documentation and licence terms.

[•]¹ While H3G recognises that Ofcom now has a general aim of trying to liberalise spectrum use, both as to application and technology, any relevant decision cannot be taken in a vacuum. It must take full account of, and not breach, the legitimate expectations that arose from previous spectrum awards and other relevant decisions and/or should be consistent with the general policy and market expectations on which such awards/decisions were based, so far as possible.

In the present case, it is therefore highly relevant that market participants relied upon the clear representations made [•]. Ofcom tries to negate this, in part, by suggesting that the possibility of a future variation of the licence to cover mobile broadband services was priced into the licence fee UK Broadband paid for its licence. This is simply not the case. The 2003 Auction was specifically for "Fixed Wireless Access" (this is in fact the title of the Information Memorandum). The Radiocommunications Agency also made it clear that mobile services would not be permitted in the UK on the 3.5GHz spectrum (as recognised in paragraph 3.14 of the Consultation). The amendment provisions in UK Broadband's licence upon which Ofcom seeks to rely are standard provisions and are not intended to be used for such fundamental upheavals as is anticipated in this Consultation.

[•]

¹[•]



No reasons are provided in the Consultation which justify granting the variations and departing from previous policy and statements. For example, Ofcom has provided no evidence that any increase in demand for mobile broadband would not be better met through existing 3G services and if necessary the UMTS Expansion Bands. As explained in the Annex to this response, there is no reason to consider that demand is unmet. In any event, to the extent that this is the case, it is due to the slower than anticipated roll-out of 3G by the incumbent mobile operators. Ofcom should not further distort the competitive structure [●].

Further, the argument that H3G and the other MNOs have a first mover advantage from having a network as they have already, or nearly have, complied with the roll-out obligation (and that this is therefore somehow enough to justify the variations) is mere assertion, without taking account of the importance - and cost – of, for example, the roll-out obligation. Moreover, the existing operators have paid for any competitive advantages through higher first mover costs and in establishing the mobile broadband market. [●]

Where investments by operators are based on clear policy statements which subsequently prove to be unreliable, the value of the spectrum is diminished [●]. This [●] impacts on decisions going forward. [●] the resulting uncertainty will [●] impact on other potential investors' view of the viability of business plans and hence the value of the spectrum to them. A perception of a risk that the conditions on which investments are made cannot later be relied upon will distort future investment incentives and reduce the efficiency of future spectrum awards.

Changing such regulatory commitments will also impact on the credibility of future awards, making them inefficient. The aim of competitive spectrum awards is that the licences are won by the party that values it the most. If potential bidders see a risk that there will be *ex post* changes to the basis on which auctions are held, this will distort *ex ante* valuations of the spectrum. In this case, it will no longer necessarily be the case that such auction awards will be efficient in the sense of awarding licences to the undertakings which value them most.

In conclusion, permitting the proposed variations is not necessary or proportionate, would be likely to cause distortion in the mobile broadband market [●].

The variations are not justified and any decision to permit them would be unreasonable

There are a number of other errors contained in the reasoning set out in the Consultation. First, Ofcom's suggestion that there is unsatisfied demand is incorrect (see sections 1 and 3 of the Annex to this letter). Mobile broadband services are already being provided in a competitive environment, which means the variations are not justified by Ofcom's duties under sections 3 and 154 of the Communications Act 2003 (the "2003 Act").

Second, Ofcom has failed to consider all relevant factors, such that it is in breach of sections 3, 4 and 154 of the 2003 Act. For example, Ofcom has failed to consider:



- whether there are greater social benefits gained from the original use of UK Broadband's licence (see section 2 of the Annex);
- the effects of the variations on UK Broadband's competitors, the impact on current market structures and whether UK Broadband is likely to be an effective competitor in any event (see sections 1, 3 and 4 of the Annex);
- [•]; and
- the fact that Ofcom's obligation to achieve economic efficiency means that it should grant spectrum to the user who values the spectrum at its highest, which ensures economic efficiency; Ofcom will have erred in the exercise of its discretion if it agrees to the variations, as this will represent an untested assumption that the incumbent, UK Broadband, is the user who most values that spectrum (taking no account of the different valuations which would have been placed on the Fixed Wireless Access licences in the 2003 Auction if they had included mobile services).

Competitive distortions from the variations and state aid issues

Furthermore, to permit the requested variations to UK Broadband's licence without re-offering it for auction, imposing proper conditions or charging a proper licence fee would inevitably distort competition in the mobile broadband sector. This would, H3G submits, also involve the grant of unlawful state aid. Ofcom's assertion² that this would not be the case because of the absence of any competitive distortion is incorrect for the reasons set out in sections 1 and 3 in the annex to this response.

Inconsistency with the Communications Directives

Any decision to permit the variations would also be in breach of the Communications Directives. The Framework Directive (2002/21/EC) provides that National Regulatory Authorities shall promote competition by inter alia ensuring that there is no distortion or restriction of competition in the electronic communications sector and by encouraging efficient use and ensuring the effective management of radio frequencies (Article 8(2)). Article 9 provides that Member States shall ensure that the allocation and assignment of radio frequencies are based on objective, transparent, non-discriminatory and proportionate criteria. These are implemented in the UK by sections 3 and 4 of the 2003 Act.

Simply providing the option for UK Broadband to extend its existing licence for mobile broadband services for free or otherwise without re-allocation in a transparent, fair and open manner would clearly discriminate against other providers of mobile broadband services. It would not be objective and would be a breach of duty under the EC Treaty and/or the 2003 Act.

² See paragraph 6.41 of the Consultation.



A new auction would be necessary

If Ofcom decides to extend use of the 3.5 GHz spectrum to include mobile broadband services, these licences should be re-assigned in a fair and non-discriminatory manner (at least consistent with Ofcom's current spectrum management policy (as set out in the Spectrum Framework Review and Liberalisation statements) so that all operators (including those who decided not to participate in the 2003 Auction on the basis that the 3.5GHz spectrum was to be strictly limited to fixed use) have equal opportunities to access it. This should be by way of a clear (i.e. no advantages to the incumbent) and transparent auction.

The impact of the variations

The annex to this response provides H3G's detailed views on the justifications advanced in the Consultation for allowing the variations under equivalent headings to those used in section 6 of the Consultation.

I would be happy to discuss the issues raised by this response further.

Yours sincerely,

A handwritten signature in cursive script, appearing to read 'Tim Lord', on a light-colored background.

Tim Lord
Regulatory Director



ANNEX

1. *The potential benefits of the variations*

Ofcom starts its analysis by noting that there is consumer demand for broadband “on the move”. H3G agrees that there is consumer demand for mobile broadband – this demand is being met.

Truly mobile broadband is already a reality for UK consumers, is being used increasingly and is provided through existing 3G networks. Further, the imminent evolution of those networks, with the introduction of HSDPA³, will increase the download speeds available significantly and the attractiveness of these services. H3G expects to be able to offer download speeds of up to 3.6MBps within a matter of months throughout its national network in the UK as it does already in Ireland and Austria. The ability to browse the internet through a truly mobile service (either on handsets or through datacards used in conjunction with a laptop) is a reality today. H3G’s customers are increasingly embracing these services such that mass market mobile email and internet usage is becoming a reality. Illustrative facts include:

- between July 2006 to January 2007 there were 82 million page views on H3G’s Yahoo internet service⁴ (from March 2007 to June 2007 there were 62 million page views);
- MSN Instant Messenger: H3G customers sent and received 118 million messages through this instant messaging system in the single month of May 2007; and
- customer research indicates that a majority of H3G mobile internet customers would recommend it and see the service as an integral part of the services H3G offers.⁵

H3G has also innovated in terms of pricing of these services, offering value for money through its “X-Series” services (which include effectively flat rate mobile broadband internet access tariffs).

H3G notes that Ofcom appears to recognise at paragraph 6.6 of the Consultation that the additional benefits of allowing UK Broadband to use its existing spectrum to offer nomadic or mobile broadband services are *incremental* to the existing mobile broadband offerings already being provided. H3G welcomes this recognition. The benefits to consumers identified by Ofcom are therefore only from the effect of the very marginal additional competition which Ofcom believes UK Broadband would provide. H3G notes that the Consultation provides no analysis or explanation of why such an additional mobile or nomadic broadband provider will create any appreciable increase in customer benefits. Ofcom appears simply to be assuming

³ “High Speed Download Packet Access”, the next evolution of the Wideband CDMA standard which is being rolled out in more than one UK 3G network currently.

⁴ This service provides a customised mobile search service which adapts many internet pages so that they are optimised for viewing on a handset. H3G has recently launched a similar service in partnership with Google.

⁵ Source : Mobile internet research, March 2007 – 20 in depth qualitative interviews



that any increase in the number of operators will necessarily create competitive benefits without carrying out a proper market analysis to show why this is the case in these particular circumstances (see section 3 of this annex below). There is no analysis in the Consultation of why UK Broadband is likely to be an effective competitor and therefore bring such benefits.

[•]

H3G's view is that Ofcom should undertake a review of the benefits of mobile broadband and therefore take a view on how to promote competition in this market most effectively. Ofcom has declined to ever undertake such a study. H3G is therefore concerned that Ofcom, through proposing to allow the variations, is planning a regulatory intervention altering the competitive landscape without an adequate understanding of what the resulting effect will be.

2. Optimal use of spectrum

The Consultation provides no convincing reasons as to why the proposed variations will promote efficient spectrum use. Indeed this is unlikely to be the case as it undermines future spectrum auctions.

First, from an efficient allocation perspective, all of the services which Ofcom identifies as potentially being offered by UK Broadband in the 3.5GHz band are already being provided in other spectrum bands by 3G technology. Ofcom has not provided any evidence that there is a shortage of spectrum or capacity in offering those services. If there is any foreseeable capacity constraint, Ofcom has provided no evidence as to why such capacity is not better provided through the UMTS Expansion Bands.⁶

Second, as a matter of principle, under a properly implemented market based approach, economic efficiency is achieved by ensuring that the spectrum goes to the user who puts the relevant spectrum to the highest value use. There is no prior reason to assume that it will be efficient in economic terms to allow an incumbent spectrum licensee, who bid for the spectrum on a different basis, to put the spectrum to whatever is the highest value use for that incumbent licensee.

Ofcom argues that allowing UK Broadband the flexibility to offer mobile services will provide it with a "freedom" to "make optimal use of the spectrum in responding to new consumer demands" enabling it "to introduce new services as they became technically and commercially feasible".⁷ This is mere assertion. Ofcom is effectively stating that UK Broadband should be enabled to use its spectrum licence for what is the highest value use to UK Broadband privately at any point in time and that this will inevitably lead to the optimal use of the

⁶ The 2.6GHz band on the award of which Ofcom is currently consulting and licences in which band Ofcom proposes to award in the near future.

⁷ Paragraph 6.13 of the Consultation.



spectrum. However Ofcom has failed to consider whether there are greater social benefits to be gained from the original use of the relevant spectrum (that is, fixed wireless access as a substitute to wired local loops). No analysis of this is contained in the Consultation.

Even ignoring the issue of externalities and any possible market failures, the approach is not consistent with Ofcom's wider market based approach to spectrum management. It appears to depart from Ofcom's existing policy. This is especially the case given Ofcom's proposal not to change the licence fees charged for this spectrum.

Third, there are technical issues. Optimal use of the radio spectrum generally also needs to take account of what demands and impacts the variations will place on other users of different radio spectrum. However, Ofcom has not considered potential fragmentation effects on the handset market of introducing a UK specific mobile broadband spectrum allocation.

The variations would also allow UK Broadband to emit at significantly higher power levels. Current 3G networks do not require such higher power limits. A priori, if alternative mobile uses of the 3.5GHz band require such higher power levels it would seem unlikely that they represent an efficient use of spectrum compared to existing 3G networks. No analysis is provided in the Consultation as to why such new and higher power levels are justified.

As such, the Consultation in fact provides no good reasons why the variations will lead to optimal spectrum use.

3. Impact on competition

H3G generally recognises the benefits of competition and does not wish to create barriers to entry. Neither, however, does it wish to be operating in an already distorted playing field with an increasing number of competitors with advantages over it. The assessment of the competitive impacts of the variations in the Consultation is insufficiently detailed and does not take account of the distortions to competition which would arise [●].

The Consultation asserts that competition will be increased by the entry of an additional operator (UK Broadband) into markets where it "does not currently operate". Ofcom then considers a range of potential relevant broadband markets which may be appropriate. All of these possible market definitions are already highly competitive with multiple networks operating. While H3G has undertaken no analysis of the relevant market for these purposes and reserves its position on the relevant market in which mobile broadband services are provided⁸, as Ofcom notes there is existing competition for the provision of mobile broadband

⁸The Consultation sets out some potential candidate markets in which to consider the competitive effect. This response considers the question in the light of these candidate markets, but this should not be taken as H3G acceptance that any one of these markets is the right market for any analysis of competition in the provision of mobile broadband services. However, H3G



services in any of its candidate markets. The Consultation essentially assumes however that an increase in the number of competitors by one will necessarily increase competition. This analysis based solely on numbers omits to consider a number of relevant factors, which should be taken into account:

- [●]^{9 10}

[●]

In relation to making other spectrum available for mobile use, Ofcom has argued that there was no need to assess whether such awards would undermine existing investment in 3G or hinder the ability of existing licensees to recover costs.¹¹ The reason given for this in relation to a previous spectrum award was that the characteristics of that particular award (in particular the quantity of spectrum available and the technical limitations) meant it was not relevant for 3G use. Neither of those restrictions apply in relation to making UK Broadband's spectrum available for mobile broadband use. [●]

4. Value of spectrum and discrimination

The Consultation, by having separate sections dealing with the value of the 3.5GHz spectrum with the variations and the issue of discrimination against existing licensees, appears to assume that these are separate issues. They are not.

As discussed above, Ofcom's approach does not include a proper assessment of the effect on downstream competition of allowing the variations. The Consultation seeks to address the potential discrimination against existing licensees (especially 3G spectrum licence holders) in terms of listing a number of potential advantages which such licensees have compared to UK Broadband if the variations are allowed. As an apparently separate matter, the Consultation also notes that Ofcom:

“considers that there do not appear to be a distortion to competition or concerns regarding the existence of potentially inefficient uses of spectrum to justify introducing an additional licence fee”.

This latter conclusion appears to be heavily based on the idea that it was known that there could be a licence variation (at the time of the original award following the 2003 Auction) such that this could have been priced into the fees paid through the 2003 Auction. This is highly

disagrees with the suggestion in paragraph 6.28 that mobile broadband services are not currently being offered and that therefore this question cannot yet be determined, as should be clear from section 1 of this response.

⁹ [●]

¹⁰ [●]

¹¹ See page 39 of “Award of available spectrum: 412-414MHz paired with 422-424Mhz” published 6 April 2006 (available at http://www.ofcom.org.uk/consult/condocs/spectrum_award/statement/statement.pdf).



controversial and, H3G submits, incorrect. H3G disagrees that such a variation was contemplated at this time of the 2003 Auction. While it is true that the 3.5GHz licences contained a standard clause on the possibility of variations under the Wireless Telegraphy Acts, this is something contained within all spectrum licences. Licensees are entitled to consider that any such variations will take account of all relevant circumstances, including statements at the time of the award concerning what will and will not be allowed. Given that the power limits and fixed restriction were explicitly stated at the time of the 2003 Auction and subsequent award (which was for a time limited period), potential bidders were legitimately entitled to expect that these fundamental restrictions would be retained subject to a major change in circumstances. The Consultation does not provide any evidence that there has been such a change in circumstances. Further, the fact that a number of bidders [●] did not bid for the 3.5GHz licences because they had a restriction to fixed use, means that the possibility of mobile use was not, by definition, priced into what UK Broadband paid for these licences.

The Consultation does not discuss, or take any account of, the potential discrimination which arises from the fact that other operators may have bid for spectrum if it had been available for mobile use at the time of the 2003 Auction. As is set out in the Consultation it was made expressly clear at the time of the award (and in the licence itself) that the 3.5GHz spectrum was only for fixed use.

[●]

5. *Timing of variations*

The Consultation sets out Ofcom's reasons for believing that the variations should be made as soon as possible. Essentially, these reasons are based on Ofcom's assumed benefits to competition and innovation which flow from the variations. For the reasons set out above, H3G does not believe that these benefits have been properly assessed or are significant. However, in considering the timing of the variations, the Consultation crucially omits to assess the costs of allowing these variations as soon as possible. [●]

6. *Objective justification for the variations and expectations at the time of the auction*

H3G's views on the arguments set out in the Consultation under these headings are set out in the main body of this response.