



**Issue 1**

BT's response to Ofcom's consultation on:

**Variation of UK Broadband's 3.4 GHz licence**

*(Issued by Ofcom on 13 June 2014)*

**Submitted to Ofcom on 22 July 2014**

## **Executive Summary**

1. BT welcomes Ofcom's decision to not pursue its earlier proposal to swap the frequencies currently licensed to UK broadband Ltd (UKB) prior to conducting the 2.3 and 3.4 GHz auction. We agree with Ofcom's decision that the newly available frequencies must instead all be awarded competitively as BT proposed.
2. We are opposed to Ofcom's proposal to extend UKB's licence for existing 3.4GHz frequency assignments beyond its current 2018 expiry: the most appropriate course of action that Ofcom should pursue is to re-award the UKB frequencies as part of the upcoming auction.
3. When considered in the round, Ofcom's consultation gives the overall impression of justifying a prior formed view, contrary to its obligation to consult when proposals are still at a formative stage. In giving special treatment to UK Broadband in relation to future access to 3.4GHz spectrum it is providing preferential treatment and discriminating against other parties in a similar position, contrary to the requirements of section 9(7)(b) of the Wireless Telegraphy Act 2006 and established principles of public law. An open and fair auction would treat all parties equally. Moreover, Ofcom provides no convincing explanation of how the proposals are compatible with its obligation under section 3(2)(a) of the Communications Act 2003 to secure optimal use of spectrum.
4. Extending the UKB licence would be a mistake for a multitude of reasons. It is not in the interests of citizens and consumers as it will perpetuate the historical highly inefficient spectrum use of that spectrum; it will create inefficiencies in the use of the remaining spectrum to be auctioned as a result of additional adjacencies between licensees; and it will prevent other parties with more credible business models from gaining access to the spectrum. Moreover, the licence extension will give UK Broadband unfair advantage in the auction process and is highly likely to result in Ofcom ending up with UKB's existing paired spectrum eventually returned to Ofcom, requiring another auction.
5. Inclusion of the spectrum within the auction is the best means to secure optimal use of the spectrum and to further the interests of citizens and consumers by supporting new competition, new investments and enabling innovative solutions. Extending the licence has no clear net benefits given that the auction is only about a year away and, importantly, it introduces clear risks that Ofcom appears not to have considered.

## **Response to the consultation questions**

### ***Question 1: Do you agree with our proposal to approve UK Broadband's licence variation request to extend the term of its licence indefinitely from 2018? Do you have any other comments you wish to make?***

6. BT had previously understood that the UKB spectrum would return to MoD in 2018, as stated in Ofcom's December 2012 consultation on the variation of 28GHz Broadband Fixed Wireless Access licences. With the planned release of other 3.4GHz spectrum in 2015/16 the opportunity exists to include this spectrum within the auction and provides a chance for bidders to acquire larger blocks of spectrum than if the UKB frequencies are excluded, which would be beneficial. It would also allow other parties who may place higher value on the spectrum and have better business cases to acquire the

spectrum rather than perpetuating the existing situation of very limited use (after many years amounting primarily to a few tens of base stations recently deployed in London).

7. In other instances of the transformation of an existing spectrum position into indefinite licences – *i.e.* the 900, 1800 and 2100MHz MNO licences – there were good reasons for the transformation, in as much as the MNOs had created large and valuable businesses, greatly to the benefit of end-users, such that depriving them of these holdings would have resulted in substantial consumer detriment. None of this logic applies to UKB's spectrum, as they have failed to build any substantial business as a result of their holding. In this circumstance the proposed licence extension treats UKB in a special manner and amounts to discrimination against other providers. An open and fair auction in due course would treat all providers in the same manner.
8. Ofcom's main justification for changing the UKB licence to indefinite duration, rather than maintaining its current 2018 expiry, is that it will provide UKB with the necessary certainty to immediately make investments in an extensive network using their licensed spectrum. We disagree with this conclusion on many grounds, including on the basis that the future pricing of the spectrum is highly relevant to this issue, and if the implications of this are more fully considered this would logically lead to the opposite solution (maintaining the 2018 expiry and re-auctioning well before this date to facilitate the possibility to continue without disruption). Putting the spectrum up for auction would obviously give rise to an opportunity for much better use by alternative owners and would allow the market to decide on the optimal use of the spectrum.
9. Ofcom's proposal to extend the UKB licence is justified analytically by a comparison of *(i)* the costs of inefficiencies and filtering if the existing UKB spectrum blocks lead to extra adjacencies compared to *(ii)* the benefits of competition of potentially cheaper broadband. Ofcom's cost benefit analysis is very narrow and fails to assess the potential benefits in terms of efficiency, innovation and also competition from allocating the spectrum to alternative user, as discussed in paragraph 12 below. However, even that analysis (Para 5.66 and Annex 5 of the consultation) reveals that with only 1 year of delay to UKB's plans, as a result of waiting for the auction to re-confirm their spectrum ownership, the benefits vs costs are very marginal, even with £20/month broadband pricing. We don't consider the other modelled scenario (4 years delay if someone else wins the spectrum) to be a valid consideration because if that scenario arose it seems likely that the winner of the spectrum in the auction could get access to it early on a geographic basis by spectrum trading, given the very limited UKB network deployments to date. Thus, even the analysis presented does not give a strong justification to extend the licence.
10. A further important point that Ofcom has not considered is that UKB has other 4G spectrum in 3.6-3.8GHz that is not subject to licence expiry, and so their plans would only need to be modified rather than stopped if they failed to retain their 3.4GHz frequencies. There is in any case no guarantee that UKB will implement its business case or that the assumed consumer pricing would be sustainable, especially given that the annual charge for the spectrum is at this point unknown. As the intended date of the auction is only about 12 months away it makes much more sense to award all available 3.4-3.6GHz spectrum, including the expiring UK Broadband spectrum, in one auction. If UKB does not commit the level investment on which Ofcom has based its proposal to extend the licence, what powers will Ofcom include (e.g. coverage / poll-out obligation) so it could then withdraw the licence?

11. Ofcom indicates that annual charges would apply after the original 2018 expiry date and that these would be decided later based on the principles of Administrative Incentive Pricing (AIP). The obvious approach would be to set these fees by annualising the market value of 3.4GHz spectrum as revealed in the auction; to do otherwise would distort competition with other parties that buy similar spectrum in the auction. Indeed the consultation suggests this is the likely basis of determining fees.
12. Given that auction prices are the most likely basis for setting post 2018 annual charges to UKB if their licence is made indefinite duration, extending the licence prior to the auction, rather than placing the spectrum in the auction, would actually create great uncertainty for them in terms of the ongoing costs of their licence. It will in effect be determined by the sums bid by others. In answer to this, Ofcom's reliance on UKB's assertion that their paramount concern is certainty of continued spectrum access, and that any higher than expected fees can be absorbed in their business plan, is not compelling. It surely simply reinforces the fact that as they are so confident that they can afford to pay the market value then they surely they should just be required to enter the auction? We note that to the contrary, in the 2.6GHz auction last year the bidding by the entity that was a subsidiary of UKB's parent company placed a relatively low valuation on additional TDD spectrum, exiting the auction with bids totalling c. £10m, far less than the ultimate winning bids by BT and others. This calls in to question UKB's appetite to pay future fees reflecting market values if the spectrum licence is extended and there is a risk that with annual charges correctly set the spectrum may not be attractive to UKB and would end up being re-awarded if they handed the licence back to Ofcom rather than paying the fees (trading may not be possible as the licence with market value based annual fees may have little sale value). This potential regulatory failure (i.e. failure to achieve the desired objective of extending UKB's licence) would have costs. The benefits that would arise to consumers from including UKB's spectrum in the auction, would be delayed by at least 3 years.
13. If the UKB licence is not extended and the spectrum is instead included in the auction, then if UKB values the spectrum *more* than others it would win it in the auction in any case. If UKB values the spectrum *less* than others it would not win it in the auction, as it is not prepared to pay the market rate. By placing the spectrum in the auction, market mechanisms would ensure that the spectrum would end up in the hands of those that valued it most and lead to most economically efficient use. Ofcom has assessed UKB's business plans, but not the business plans of other parties who might use the spectrum in different ways and may have significantly greater valuation. Hence it is not possible to determine whether the UKB investment proposals are better than other uses of the spectrum that other parties may formulate.
14. Inclusion of the frequencies in the auction would have the important added advantage that larger contiguous blocks can be won and inefficiencies of boundaries between operators would be reduced. Indeed Ofcom mentions an indicative spectrum value of £1.5m/MHz and estimates that the added cost to UKB of the non-contiguous 40MHz assignment is £83m, suggesting that it would be cheaper for UKB to obtain new spectrum at auction even before on-going fees of existing spectrum is considered. Indeed this fact highlights a serious risk that Ofcom may have overlooked. In effect, by extending the existing licence before the auction, Ofcom is giving UKB a spectrum guarantee of securing a minimum amount of 3.4GHz spectrum that other new entrants do not have. In addition, with UKB having the ability to hand its licence back after the auction, and before 2018 to avoid ever paying annual charges, then given that they would prefer a contiguous block to achieve lowest deployment costs (especially as existing

deployment of systems in their spectrum to date is very limited), there is every likelihood that if they do have a business case compatible with market value of 3.4GHz spectrum then they would buy new spectrum in the auction. **Hence there is a clear risk that with pricing of their existing licence tied to the market value in the auction, the likelihood is that UKB would most logically purchase new contiguous spectrum in the auction and then relinquish its existing licence (or if permitted part of those frequencies), leaving Ofcom the problem of needing to re-auction it and seeing spectrum left unused.** How does Ofcom intend to address this concern and ensure that if UKB buys additional spectrum in the auction it cannot then relinquish its existing spectrum licence?

15. If Ofcom will not maintain the 2018 licence expiry, a compromise option that Ofcom has not considered is to “grandfather” any existing UKB deployments at the time of the auction and allow them to continue to operate these in the spectrum awarded to another licensee, with UKB paying fees to Ofcom for these limited deployments for any operations beyond 2018 based on a pro-rata calculation of the proportion of the population coverage that is sterilized.

***Question 2: Do you agree that if the variation to UK Broadband’s 3.4GHz spectrum licence is approved then fees should be charged on an annual AIP basis?***

16. Yes, if Ofcom does continue with its present proposal to make the UKB licence duration indefinite, then annual charges reflecting the market value of the spectrum as revealed in the auction should be the relevant benchmark for setting the annual charges.
17. UKB operates in the same downstream markets as those using other frequency bands to provide wireless broadband services. As such, to avoid any regulatory distortion to competition Ofcom will have to ensure that whatever basis is used for setting any administrative licence fees will need to be consistent with the methodology applied to other providers in these markets – that is, using the same full market value approach applied to 900MHz and 1800MHz spectrum licences.
18. The difficulty of setting appropriate annual charges will be apparent to Ofcom from the current activity in relation to 900/1800MHz spectrum. If instead all the 3.4 - 3.6GHz spectrum is auctioned this would avoid the need to carry out this exercise for the UK broadband licence frequencies.

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