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NON-CONFIDENTIAL

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Dear Gideon,

Thank you for the opportunity to discuss Ofcom's proposal to align licence terms in the 3.4-3.8 GHz band on 8 September 2022.¹ Having had the opportunity to review the responses of others to your Consultation on this proposal, we feel it is important to draw your attention to elements of these responses which support our assessment that:

- the problem that Ofcom seeks to address is unclear, and
- an existing legal solution is available when the problem concerns a potential barrier to defragmentation in this band.

We would ask that Ofcom takes due account of our assessment when deciding on its next steps. Ofcom has a duty to exercise its functions as economic regulator in a way that meets its statutory duties, including its principal duty to further the interests of both citizens and consumers and for the reasons set out in this letter we consider that to meet these duties Ofcom must consult further ahead of making any decision in this regard.

At paragraphs 3.13-3.15 of your Consultation, Ofcom states that it seeks to reduce barriers to trading by bringing down transaction costs and other barriers. We understand that Three and one other MNO have told Ofcom that they face difficulties in agreeing trades in this band because of the disparity in licence terms and that this provides the justification for Ofcom's proposal.

What problem is Ofcom seeking to address? The issue may be the structure of prices, but evidence proves that it cannot be the level

Table 3.1 of the Consultation sets out the disparity in licence terms which Ofcom believes may be problematic.

¹ Proposals as set out in Ofcom's 2022 Consultation on *Aligning Licence Terms in the 3.4-3.8 GHz band*, available [here](#).



Table 3.1: Summary of licence terms in the 3.4-3.8 GHz band

	UKB licences	Auctioned licences
3.4-3.6 GHz	<p>Awarded in the 2003 auction.</p> <p>Indefinite duration, subject to 5 years' notice.</p> <p>Subject to payment of annual licence fees (ALFs) now.</p>	<p>Awarded to winners of the 2018 auction.</p> <p>Indefinite duration, subject to 5 years' notice from 2033.</p> <p>The licences become subject to ALFs from 2038.</p>
3.6-3.8 GHz	<p>Initially administratively granted in 1992.</p> <p>Indefinite duration, subject to 5 years' notice.</p> <p>Subject to payment of annual licence fees (ALFs) now.</p> <p>Spectrum leasing permitted.</p>	<p>Awarded to winners of the 2021 auction.</p> <p>Indefinite duration, subject to 5 years' notice from 2036.</p> <p>The licences become subject to ALFs from 2041.</p> <p>Spectrum leasing not permitted.</p>

Source: Table 3.1 as per page 9 of Ofcom's 2022 Consultation on *Aligning licence terms in the 3.4 – 3.8 GHz band*.

It is obvious from this table that Ofcom is concerned about the structure of prices, rather than the actual prices paid for spectrum. Otherwise, it would have explicitly stated that the difference in licence fees paid by UKB for 3.4 versus 3.6 GHz spectrum is also an issue.

If the differing level of prices were a problem *per se* for spectrum trading, then we note this is not something Ofcom has previously sought to solve in another context. In the 3.4 and 3.6 GHz auctions, different bidders paid different prices for spectrum in the same band by luck of a random draw. Ofcom did not seek to normalise prices in these auctions, presumably it must have felt that the spectrum market could effectively function despite this disparity.

Indeed, there is compelling evidence that the level of prices can be dealt with in a spectrum trade, including in instances where disparity of prices is much larger than that *arising between spectrum awarded in the same process*. After the 3.6 GHz award primary round, O2 and Vodafone agreed to trade spectrum between the 3.4 and 3.6 GHz bands, spectrum that has the same price structure but was sold for markedly different fixed prices.

Table 1: prices and term differences between spectrum sold in the 3.4 and 3.6 GHz auctions

	3.4 GHz auction	3.6 GHz auction
Price per MHz	£7.56m (in April 2018 prices)	£4.41m (in April 2021 prices)
Term period	Subject to ALFs from April 2033 onward	Subject to ALFs from April 2038 onward

Source: based on the results of the 3.4 and 3.6 GHz auctions as published on Ofcom's website.

Therefore, it is a proven evidential point that the level of prices does not prohibit trading. Ofcom cannot lawfully rely on this justification to alter the level of Three's ALFs when setting a fixed fee, as the precedent of the O2 / Vodafone trade establishes that differences in the level of prices do not constitute a barrier to spectrum trading.



Three's Consultation response adds further weight to this distinction between the structure and the level of prices:

"The above differences between spectrum licences auctioned in 2018 and 2021 on the one hand and UKB's licences on the other are problematic for two main reasons:

- First, there is a large disparity between the ALF that Three pays for UKB's 120MHz in the band and what other MNOs paid for equivalent spectrum in the April 2021 3.6-3.8GHz auction;*
- Second, the difference in licence terms has prevented trades that would help defragment the 3.4-3.8GHz band – in the past, Three has explored potential swaps [redacted] but progress has not been possible due to the ALF liability and uncertainty about its future level."²*

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]. Yet, if price were a material factor it would have prohibited the spectrum swap between O2 and Vodafone.

There is a legal route available to support spectrum swaps and plausible spectrum trades

If Ofcom's problem concerns a specific issue with defragmentation of the 3.4-3.8 GHz band, our Consultation response identified a legal solution which involves allowing the licence terms of ALF-bearing spectrum to move with its current licence holder, Three. This would allow Three to agree a spectrum swap with another MNO where the position of spectrum held by MNOs involved changes yet both MNOs retain the terms that apply to their current spectrum holdings. This would enable trades that change the position but not the amount of spectrum held by MNOs in this band.

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] A pure swap, with no disposal, can be achieved through the legal approach adopted for the 3.4 GHz auction.

As we observed in our meeting, this is the most proportionate solution because:

- it delivers the benefits of defragmentation with 100% certainty, in that it is implemented by Ofcom in response to a trading request from the relevant parties; whereas
- Ofcom's proposal to change licence terms appears only to reduce the price of Three's spectrum (with 100% certainty) and leave to chance the occurrence of a future spectrum trade and thus whether benefits of defragmentation will be delivered.³ Moreover, it comes at the substantial cost of +£400m in net present value terms for UK tax payers (citizens).

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² Page 4 of Three's non-confidential response to Ofcom's Consultation. Available [here](#).

³ Additionally, we consider that Ofcom's proposal goes against its earlier commitment to review UKB's 3.x ALFs only if there would be strong evidence of material misalignment between the level of fees and the value of the spectrum.



Looking beyond a direct swap of spectrum (as in the O2 / Vodafone trade), we note that Three holds 20 MHz of spectrum acquired in the 3.4 GHz auction which comes with the same licence terms as the spectrum that other MNOs hold in this band. Combining this with the fungibility of licences we set out above, means that Three and another MNO would be able to agree on trades involving both changes in the position of spectrum and ownership, where Three sells up to 20 MHz of its spectrum in this band to the other MNO without a change in licence terms being required.

This would cover the plausible scope of trades that Three and other MNOs could be interested in, as it would lead to the recipient MNO having a 100 MHz carrier in the band (the maximum supported by the technology). This being the case, no barriers to trades in this band are present when Ofcom supports Three and the other MNO in changing the position of their spectrum within this band whilst MNOs retain current licence terms.

Conclusion

As we identified in our Consultation response, there is no objective justification for Ofcom to change the licence terms of Three's ALF-bearing 3.x GHz spectrum. There is a legal route available that supports spectrum swaps and a plausible range of spectrum trades that Three may agree on and which means that Ofcom does not have to engage with the issue of repricing spectrum.

The Consultation is premised on the perceived problem being the level of pricing. However, when this is considered evidentially as we have done above, this is not supported. Accordingly, we suggest that it would be premature for Ofcom to come to any decision on this matter and submit that Ofcom reconsult to ensure that the right question is being addressed, all the relevant evidence and options are taken into account and all relevant stakeholders are given the opportunity to comment in this regard.

In the meantime, we must reserve all our rights accordingly.

Yours sincerely

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**Director of regulation and public policy
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